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Title: Jersey Shore State Bank, Petitioner
v.
United States

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ril 22, 1986

Court: United States Court of Appeals
for the Third Circuit

Counsel for petitioner: Flayhart, Martin A.

Counsel for respondent: Solicitor General

try	Date	Note	Proceedings and Orders
1	Apr 22 1986	G	Petition for writ of certiorari filed.
2	May 9 1986		Memorandum of respondent United States filed.
3	May 13 1986		DISTRIBUTED. May 29, 1986
4	May 23 1986		REDISTRIBUTED. May 29, 1986
5	Jun 2 1986		Petition GRANTED.
6	May 28 1986		Unpublished Ninth Circuit Opinion received and distributed.
7	Jul 7 1986		Order extending time to file brief of petitioner on the merits until August 2, 1986.
8	Jul 31 1986		Joint appendix filed.
9	Jul 31 1986		Brief of petitioner Jersey Shore State Bank filed.
10	Aug 1 1986		Brief amicus curiae of American Bankers Assn. filed.
11	Aug 2 1986		Brief amicus curiae of First Alabama Bank filed.
12	Aug 7 1986		Record filed.
13	Aug 27 1986		Order extending time to file brief of respondent on the merits until September 23, 1986.
14	Sep 22 1986		Order further extending time to file brief of respondent on the merits until October 6, 1986.
15	Oct 6 1986		SEE FOR ARGUMENT. Monday, December 8, 1986. (3rd case) (1 hour).
16	Oct 8 1986		Brief of respondent filed.
17	Oct 22 1986		CIRCULATED.
18	Nov 24 1986	X	Repl. Brief of petitioner Jersey Shore State Bank filed.
19	Dec 8 1986		ARGUED.

85-1736
No.

Supreme Court, U.S.

FILED

APR 22 1986

JOSEPH F. SPANIOL, JR.
CLERK

In The
Supreme Court of the United States

October Term, 1985

JERSEY SHORE STATE BANK,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

**PETITION FOR WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE THIRD CIRCUIT**

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QUESTION PRESENTED

Whether the Third Circuit Court of Appeals was correct in holding that the Internal Revenue Service does not need to give a third party lender notice pursuant to Section 6303(a) of the Internal Revenue Code of an assessment against an employer for unpaid employee income withholding taxes and Federal Insurance Contribution Act ("FICA") taxes in order for the Internal Revenue Service to obtain judgment against such third party lender for the employer's liability for these taxes under Sections 3505(a) and 3505(b) of the Internal Revenue Code.

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No.

In The

Supreme Court of the United States

October Term, 1985

JERSEY SHORE STATE BANK,

Petitioner,

vs.

UNITED STATES OF AMERICA,

*Respondent.***PETITION FOR WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE THIRD CIRCUIT**

Petitioner respectfully requests that a writ of certiorari be issued to review the decision and judgment of the United States Court of Appeals for the Third Circuit, entered on January 10, 1986; rehearing denied February 4, 1986, which reversed the decision of the United States District Court for the Middle District of Pennsylvania granting summary judgment in favor of the petitioner.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 781 F. 2d 974 (Appendix, *infra*, 1a-24a). The opinion of the District Court is unreported (27a-37a).

JURISDICTION

The judgment of the Court of Appeals was entered on January 10, 1986 (1a-24a). A timely petition for rehearing was denied on February 4, 1986 (25a-26a). This Court has jurisdiction to review the judgment of the Court of Appeals by writ of certiorari pursuant to 28 U.S.C. Section 1254(1).

STATUTES INVOLVED

Sections 3505, 6303(a), 6501(a) and 6502(a)(1) of the Internal Revenue Code of 1954 (26 U.S.C.) and 40 U.S.C. Section 270(a)(d) are set out in a statutory appendix (50a-52a).

STATEMENT OF FACTS

1. On December 30, 1983 the United States ("the government") brought this suit in the United States District Court for the Middle District of Pennsylvania against the petitioner, Jersey Shore State Bank¹ ("Jersey Shore" or "the Bank") in order to collect all employee withholding taxes and FICA taxes which Pennmount Industries, Inc. ("Pennmount"), a third party, had failed to pay to the United States together with accrued penalties and interest for the fourth quarter of 1977 through the first quarter of 1980 (32a, 38a-45a). The government sought to impose liability on the Bank as a third party lender pursuant to Section 3505 of

1. Jersey Shore State Bank is a wholly owned subsidiary of Penns Woods Bancorp, Inc.

the Internal Revenue Code.² The basis for Count I of the suit by the government was Section 3505(a) of the Code and the basis for Count II of the suit was Section 3505(b) (38a-45a). The Bank filed an answer admitting that it had provided money to Pennmount in the normal course of making commercial loans and raised as a defense, *inter alia*, to both Counts I and II of the complaint the failure of the government to provide the Bank with notice within sixty days of the making of each assessment against Pennmount for non-payment of federal withholding taxes and FICA taxes as required by Section 6303(a) of the Code (46a-49a).

The government moved for summary judgment against the Bank with respect to Count I relating to the liability of the Bank under Section 3505(a). The Bank cross moved for summary judgment on Counts I and II relying on the failure of the United States to give notice to the Bank of the assessments against Pennmount as required by Section 6303(a) of the Code (3a). The government admitted that the Bank had not been given notice with respect to the assessments against Pennmount which the government sought to collect from the Bank and asserted that no such notice was required (3a).

The District Court on March 20, 1985, entered judgment in favor of the Bank on its motion for summary judgment following the rationale of the Seventh Circuit Court of Appeals in *United States v. Associates Commercial Corp.*, 721 F. 2d 1094 (7th Cir. 1983) (33a-38a). The District Court stated: "Furthermore, it is undisputed that the function of the notice and demand requirement in § 6303(a) is to protect the taxpayer. *Macatee, Inc. vs. United States*, 214 F. 2d 717, 719 (5th Cir. 1954). Yet, the United

2. Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended ("the Code" or "I.R.C.").

States argues that § 6303(a) requires notice only to those parties whose names appear on the assessment list. Such an interpretation runs afoul of the plain language of the statute which specifically requires that notice be given *each person liable for the unpaid tax*, stating the amount due and demanding payment thereof." (34a).

The government filed an appeal from the decision of the District Court in favor of the Bank with the Third Circuit Court of Appeals (2a).

2. The Court of Appeals for the Third Circuit by a 2-1 panel majority reversed the decision of the District Court on January 10, 1986, with a dissenting opinion filed by Judge Weis (1a-24a). The majority opinion of the panel while noting that "... section 6303(a) can plausibly be read to support the position of both the government and Jersey Shore ..." found that Section 6303(a) notice was not required to be sent to a third party lender in order for the United States to proceed with a civil suit against such lender under Section 3505 (10a, 21a). The dissenting opinion of Judge Weis noted: "The issue in this case is not complicated—it is simply whether we read the Internal Revenue Code as Congress wrote it or as the Internal Revenue Service would like us to amend it." (21a).

The Bank filed a timely petition for rehearing which was denied by the Court of Appeals for the Third Circuit on February 4, 1986 (25a).

REASONS FOR GRANTING THE WRIT

1. The Court of Appeals for the Third Circuit has decided the tax issue raised in this matter squarely in opposition with the decision of the Eleventh Circuit Court of Appeals in *United States v. Merchants National Bank of Mobile*, 772 F. 2d 1522 (11th Cir. 1985) (per curiam), petition for *cert.* pending to No. 85-1480. The Eleventh Circuit in the latter case rejected the argument of the United States that no notice was required under Section 6303(a) of the Code as a prerequisite to suit against a lender for unpaid federal employment taxes of a third party employer. The Eleventh Circuit followed the decision of the Seventh Circuit Court of Appeals in *United States v. Associates Commercial Corp.*, 721 F. 2d 1094 (7th Cir. 1983) adopting the rationale of the *Associates* court in holding that Section 6303(a) "requires that notice of an assessment of unpaid taxes must be provided to 'each person liable for the unpaid tax' within sixty days after the assessment was made, unless otherwise provided by the Internal Revenue Code." 772 F. 2d 1522, 1524, citing *Associates*, 721 F. 2d at 1098.

Depending upon the fortuitous circumstance of the Circuit in which suit is brought by the United States for collection of federal employment and FICA taxes against a third party lender pursuant to Section 3505 of the Code will now result in a varying interpretation between the Third, Seventh and Eleventh Circuits Courts of Appeals regarding the obligation of the government for providing notice under Section 6303(a) of the Code to such lender within sixty days of an assessment being made.

Additional appeals involving an interpretation of Section 6303(a) of the Code are now pending in the Third³, Eighth⁴, and Ninth⁵ Circuits.

3. *United States v. American Bank & Trust Co.*, No. 85-1615.

2. Section 6303(a) of the Code is clear in its requirement that once the United States has made a tax assessment that notice of that assessment must be given within sixty days "to each person liable for the unpaid tax." (51a). As noted by Judge Weis in his dissent in the present case:

"The reference to 'each person liable' in § 6303 is not in the least ambiguous. In the case at hand, the government contends that defendant is liable for the tax. Therefore, it seems inescapable that defendant should have been given notice.

The IRS wishes us to redraft that section so that it requires notice only to those individuals against whom taxes have been assessed. The reasons offered for this revision have some logic and would possibly ease administrative burdens on the government, but the arguments are directed to the wrong forum. They should be presented to Congress, not the courts." (22a).

In the present case, the Bank made commercial loans to Pennmount in the normal course of business. More than five years after Pennmount had begun to fail to make payment of federal employment and FICA taxes due to the United States, the government filed the present suit against the Bank for third party derivative tax liability pursuant to Sections 3505(a) and 3505(b) of the Code. At no time did the United States provide notice to

(Cont'd)

4. *United States v. Messina Builders & Contractors Co.*, No. 85-2505.

5. *United States v. Harvis Construction Co.*, No. 86-1540; *United States v. United California Bank*, No. 85-1873; *United States v. Hunter Engineers & Constructors, Inc.*, No. 84-2652 (argued Nov. 20, 1985).

the Bank of any assessment which it had made for the unpaid taxes against Pennmount as required under Section 6303(a) of the Code (31a).

The government argues that requiring such notice to be given to third party lenders would impose an undue administrative burden on the Internal Revenue Service (19a-22a). The argument of the government, however, ignores the provision of Section 6501(a) of the Code which allows the IRS three years from the time that the employer's tax return has been filed to impose an assessment against the taxpayer (51a). Accordingly the period for the investigation which the government argues is impossible to perform within sixty days is unapplicable, inasmuch as the government has three years to file the assessment against the employer, or alternately, against the third party lender before the running of the sixty day notice period begins. It is during the latter time that adequate investigation could be made by the government with regard to third party lenders whom the government might wish to hold liable under Section 3505 of the Code.⁶

The provisions of Section 3505 of the Code imposing liability on third party lenders constitutes an extraordinary remedy which Congress enacted in favor of the Government to hold third parties liable for unpaid taxes. H. R. Rep. No. 1884, 89th Cong., 2d Sess. at 20; S. Rep. No. 1708, 89th Cong., 2d Sess. at 21-22.

6. See Gombinski, *A Noticeable Restriction: Imposing Section 3505 Liability After Associates*, 62 *Taxes - The Tax Magazine* 757 (Nov. 1984), where it is noted: "Since Section 6501 would allow the government to make this separate assessment any time within three years from the date that the employer's tax return is deemed to be filed, the government would be afforded reasonable time in which to determine the existence of those lenders who may be liable for the employer's unpaid tax." *Id.* at 770.

It is submitted that if Congress had intended that the provisions of Section 6303(a) relative to the sixty days notice of an assessment were not to apply to persons whom the government seeks to hold liable under Section 3505, then an exception would have been placed in the statute to indicate this fact. Such an exception is not, however, present.

As a policy matter, providing timely notice to a lender of an assessment against an employer would put the lender on notice of tax liability and allow the lender to evaluate its relationship with the borrower. In the present case the first notice of liability that the Bank received was the filing of the lawsuit in District Court, more than five years after the first tax liability against Pennmount arose (32a).

3. The majority opinion of the Third Circuit in the present case failed to take notice of the fact that the filing of the tax assessment confers additional procedural benefits upon the government. Under Section 6501 of the Code, once the IRS has made the assessment within three years from the time that the tax liability arises against the employer, then it has the benefit of an additional six year period of time in order to file suit against a third party lender. (50a). The government, therefore, has the advantage of an additional six years in which to bring suit without any responsibility for giving a third party lender notice of such tax assessment, which would allow the third party lender to evaluate its ongoing relationship with the employer borrower, knowing that the government intends to hold the lender liable for the taxes. As noted by Judge Weis in his dissent in the instant case in the Third Circuit:

"It bears mentioning that the dispute here is not about a meaningless formality. The assessment of taxes against Pennmount had the effect of enlarging the statute of limitations against

defendant bank for six years. 26 U.S.C. § 6502(a)1. *United States v. Associates Commercial Corp.*, 721 F. 2d 1094, 1097 (7th Cir. 1983). The likelihood of prejudice because of the loss or destruction of records by one secondarily liable is real and substantial. *United States v. Associates Commercial Corp.*, 548 F. Supp. 171, 174 (N.D. Ill. 1982).

The net effect of the Code revision urged by the IRS is to give less procedural protection to one secondarily liable than to the primary obligor. The notice of assessment will alert the taxpayer directly liable to the lengthened statute of limitations. He may then preserve pertinent records, arrange for payment, compromise, or take other steps in his own best interests. Without notice of the assessment, however, the party liable under § 3505 may not be alerted to his continuing exposure and concomitant risks. I am not convinced that Congress intended such an anomalous result." (23a).

4. The majority opinion of the Third Circuit misapprehended the legislative history with regard to the enactment of Section 3505 of the Code. The opinion in interpreting the meaning of Section 3505 of the Code made reference to the Congressional Reports of the Senate and House, quoting the language from those sections of the reports which related not to the enactment of Section 3505 of the Code but to the amendment to Section 1 of the Miller Act, 49 Stat. 793, referencing the requirements for performance bonds on public works (18a-19a). The latter amendment was enacted as part of the Federal Tax Lien Act of 1966, Pub. L. 89-719, which also included enactment of Section 3505 of the Code.

The majority opinion noted: "Although we do not intend to downplay the potential burden resulting from our construction of section 6303(a), we find the legislative history of Section 3505 quite instructive on the question of prejudice to parties like Jersey Shore." (18a).

Section 1 of the Miller Act, *supra*, is contained in 40 U.S.C. Section 270(a)(d). The latter section requires a performance bond to be posted by a contractor for government contracts to insure payment of payroll associated taxes to the government. While the discussion in the House and Senate Reports of Section 3505 of the Code appears in part E1 of the reports, the language cited by the majority opinion in the instant case, is contained in part E2 of both the House and Senate Reports which discusses the amendment to the Miller Act, *supra*, 40 U.S.C. Section 270(a)(d) (18a-19a).

The language of the aforesaid amendment to the Miller Act requiring performance bonds from contractors in order to insure payment of government taxes associated with payrolls, comports with the view expressed in the majority opinion that sureties and lenders are in essence the better risk bearers to include the costs of potential payroll tax liabilities in their premiums or as part of their loan security (18a-19a). Such an interpretation would be consistent with the performance bond requirements of the Miller Act, *supra*, when sureties are acting as obligors on a bond, or lenders are acting as guarantors of payroll taxes on a loan.

The language from the House and Senate Reports as quoted by the majority opinion of the Third Circuit does not comport, however, with its interpretation of the congressional purpose in enacting Section 3505 of the Code (18a-19a). If as the majority opinion notes, liability under Section 3505 of the Code arises only if the lender has actual knowledge that the employer does not intend to or will not pay over the taxes required to be withheld, or alternately, is itself directly paying net wages without payment

of the payroll taxes; the question arises as to why, given such a scienter requirement under 3505, would the Senate and House Reports above quoted by the majority opinion, purportedly as an interpretation of Section 3505 of the Code, indicate that lenders could protect themselves against such losses attributable to withholding taxes "by their including the amounts in their loans and taking adequate security." (18a-19a) citing S. Rep. No. 1708 at 23; H.R. Rep. No. 1884, at 22.

If in fact the language of the legislative history cited in the majority panel opinion in the instant case applies to Section 3505, then the above referenced language in the reports is not logical inasmuch as there would be no need for lenders to include possible tax liabilities in their loans, as liability for such payroll taxes could never result under Section 3505 absent some volitional cognitive act on the part of the lenders with regard to the nonpayment of payroll taxes of a contractor.

Inasmuch as such an interpretation results in a nullity, it is submitted that the language above cited by the majority opinion from the House and Senate Reports actually is a commentary on the amendment to Section 1 of the Miller Act, *supra*, with reference to performance bond requirements to be furnished by contractors. Indeed the sections of both the House and Senate Reports where the commentary cited by the Third Circuit appears would support such a view (18a-19a). In such situations, it is obvious that when a surety provides a performance bond which includes a guarantee of payment of payroll taxes, or alternately, when a lender in effect provides a performance bond by guaranteeing payment of payroll taxes under 40 U.S.C. Section 270(a)(d), that both the surety and the lender are acting as guarantors of the taxes, thereby subjecting themselves to an absolute liability in the event that such taxes are not paid by the contractor. In this context, the surety can provide protection by increasing the premiums on the performance bond, and the lender

can likewise provide protection by increasing its loan fees and taking additional security to cover such potential loss.

Such absolute liability is not the case, however, under Section 3505 of the Code. It is submitted therefore that the legislative history cited by the majority opinion in the instant case does not support its interpretation of Section 3505 of the Code.

5. As noted previously, a petition for certiorari has been filed by the Solicitor General on behalf of the United States and is pending before this Court to Number 85-1480 in the case of *United States v. Merchants National Bank of Mobile, supra*, at 5. Due to the fact that the instant case also involves a consideration of the same tax issues raised with regard to an interpretation of the notice provision of Section 6303(a) of the Code as it relates to liability sought to be imposed on a third party lender under Section 3505 of the Code, it is submitted that the petition for certiorari in the instant case should be granted and joined for argument with *Merchants National Bank of Mobile, supra*, before this Court.

Alternately, assuming that the petition for certiorari in *United States v. Merchants National Bank of Mobile, supra*, is granted, the petitioner would request that the judgment of the Third Circuit Court of Appeals in the instant case be stayed pending a decision by this Court with regard to the tax issues raised as noted above.

CONCLUSION

For the foregoing reasons, the petitioner respectfully requests that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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April, 1986

APPENDIX A—OPINION OF THE UNITED STATES COURT
OF APPEALS FOR THE THIRD CIRCUIT

No. 85-5263

UNITED STATES OF AMERICA,

Appellant

v.

JERSEY SHORE STATE BANK

Appellee

Appeal from the United States District Court
for the Middle District of Pennsylvania

Argued: November 5, 1985

Present: SEITZ, WEIS, and ROSENN,
Circuit Judges.

(Opinion Filed: JANUARY 10, 1986)

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Appendix A

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OPINION OF THE COURT

SEITZ, *Circuit Judge*.

The United States appeals from an order of the district court granting summary judgment in favor of the defendant, Jersey Shore State Bank ("Jersey Shore" or "the Bank"). This court has jurisdiction over the appeal by virtue of 28 U.S.C. § 1291 (1982).

I.

The United States brought this action alleging that Jersey Shore was personally liable under I.R.C. § 3505(a) and (b) (1982) for the unpaid federal withholding tax liabilities of Pennmount Industries, Inc. ("Pennmount"). The complaint alleged that from the fourth quarter of 1977 through the first quarter of 1980, Jersey Shore (i) paid wages directly to Pennmount employees and (ii) supplied funds to Pennmount for the specific purpose of paying wages with actual notice and knowledge that Pennmount did not intend to, or would not be able to, make timely payments or deposits of the federal taxes required to be deducted and withheld. The complaint also alleged that the Bank's liability under section 3505(a) totals \$76,547.57 plus interest, and that its liability under section 3505(b) totals \$72,069.00 plus interest.

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In its answer, Jersey Shore admitted making commercial loans to Pennmount, but denied any liability under section 3505. The Bank also alleged that the complaint failed to state a claim upon which relief could be granted, because the United States did not provide it with timely notice of the assessments against Pennmount, which it asserted were required by I.R.C. § 6303(a) (1982).

The United States moved for partial summary judgment with respect to the first count of its complaint, which involved Jersey Shore's liability under section 3505(a). At the same time, the Bank moved for summary judgment on both counts of the government's complaint, arguing that the government's failure to give it notice of the assessments against Pennmount pursuant to section 6303(a) precluded the United States from bringing suit. In its reply, the United States admitted that Jersey Shore had not been given notice pursuant to section 6303(a), but argued that it was not required to give the Bank such notice and, alternatively, that even assuming that such notice was required, the failure to give it did not bar the United States from bringing suit to collect the Bank's liability under section 3505.¹

Relying upon the Seventh Circuit's opinion in *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983), the district court held that where a lender is liable under section 3505 for another's withholding taxes, the government is required by section 6303(a) to give notice of the assessment against the employer to the lender within sixty days of the assessment. It concluded that the government's failure to give timely notice to Jersey

1. The United States also argued that Jersey Shore received actual notice of its potential liability for Pennmount's withholding taxes as early as January of 1979.

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Shore of the assessments against Pennmount barred the United States from bringing suit. This appeal followed.

II.

Prior to 1966, only "employers" were liable for income, social security, and railroad retirement taxes required to be withheld and deducted from employee wages--despite the many situations in which persons other than employers directly or indirectly paid the wages. Problems arose when these third parties paid the employees only "net" wages, neglecting to pay to the government the withholding taxes due. When this occurred, the government was often unable to collect the taxes required to be deducted and withheld, despite the fact that it was required to credit the employees' accounts for them. Recourse against the employer was often fruitless, because it was frequently without any financial resources. And the government could not proceed against the third parties who paid the net wages, because they were not "employers" under the Code and, therefore, were not liable for the taxes. S. Rep. No. 1708, 89th Cong., 2d Sess. 21-22, *reprinted in* 1966 U.S. Code Cong. & Ad. News 3722, 3742-43 [hereinafter cited as S. Rep. No. 1708]; H.R. Rep. No. 1884, 89th Cong., 2d Sess. 20 (1966) [hereinafter cited as H.R. Rep. No. 1884].

This practice, commonly known as "net payroll financing," was apparently quite prevalent in the construction industry. *See generally United States v. Algernon Blair, Inc.*, 441 F.2d 1379 (5th Cir. 1971). In an attempt to keep work moving along smoothly, prime contractors would provide their financially troubled subcontractors with the funds necessary to meet their payrolls, *see id.* at 1381, or would help them arrange the necessary credit through a third-party lender, *see*

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United States v. Coconut Grove Bank, 545 F.2d 502, 505 (5th Cir. 1977). However, anxious to limit their exposure on such transactions, the prime contractor or third-party lender typically provided the subcontractor funds only to the extent of its *net* payroll, thus making the government an unwilling "co-lender" of such loans to the extent of the withholding taxes due.

To stem this loss of revenue, Congress enacted section 3505. *See Coconut Grove Bank*, 545 F.2d at 505; *Algernon Blair, Inc.*, 441 F.2d at 1381. It imposes liability on lenders, sureties, and other third parties in two specific situations. First, section 3505(a) provides, in pertinent part, that:

if a lender, surety, or other person, who is not an employer with respect to an employee . . . pays wages *directly* to such an employee . . . such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld [emphasis added].

Similarly, section 3505(b) provides, in pertinent part, that:

[i]f a lender, surety, or other person supplies funds to . . . an employer for the *specific purpose of paying wages* of the employees of such employer, with *actual notice or knowledge* . . . that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required . . . to be deducted and withheld by such employer . . . such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which

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are not paid over to the United States by such employer [emphasis added].

In short, Congress thought it fair to impose liability on third parties like Jersey Shore in these two situations, because they sit in essentially the same position vis-a-vis control over payroll funds and access to information as the employer itself. See S. Rep. No. 1708, at 22 (observing that given the amount of information available to such third parties and the burden of proof upon the government, there is "no reason for distinguishing between the portion of the total wages which is owed and should be paid to employees . . . and the portion of the wages which is owed and should be paid to the Government"); H.R. Rep. No. 1884, at 20 (*id.*).

With this background, we turn to the issue posed by the present appeal: Whether the government's failure to provide Jersey Shore with notice of the assessments against Pennmount pursuant to I.R.C. § 6303(a) (1982) bars its suit to collect the Bank's liability under I.R.C. § 3505 (1982).

III.

"When interpreting a statute, the starting point is of course the language of the statute itself. If the language is clear and unambiguous, and there is no 'clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive.'" *National Freight v. Larson*, 760 F.2d 499, 503 (3d Cir.) (citation omitted), *cert. denied*, 106 S. Ct. 228 (1985), quoting *Consumer Prod. Safety Comm'n v. GTE Sylvania*, 447 U.S. 102, 108 (1980).

Section 6303(a), the notice provision presently at issue, is found in Subtitle F of the Internal Code, which governs procedure under and administration of the internal revenue laws. It provides, in pertinent part, as follows:

Appendix A

§ 6303. Notice and demand for tax

(a) General rule

Where it is not otherwise provided by this title, the Secretary shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof.

Jersey Shore argues that the phrase "each person liable for the unpaid tax" requires that notice of the assessment be sent not only to the persons against whom the assessment has been made, but to every third party who might be liable for the tax, including those liable under section 3505.

This interpretation of section 6303(a) concededly derives some support from a literal reading of the language of the statute. See *Associates Commercial Corp.*, 721 F.2d at 1098 (holding that "since Associates is a 'person liable for the unpaid tax' for the purposes of Section 6303(a), it is entitled to notice of the assessment of the unpaid tax mandated by that statute") (citation omitted); accord *United States v. Merchants Nat. Bank*, 772 F.2d 1522, 1524 (11th Cir. 1985) (*per curiam*).² However, even "the use of the

2. In addition to the Seventh and Eleventh Circuits, the district courts that have addressed this question are in substantial agreement that failure to provide a third party with notice pursuant to section 6303(a) bars suit under section 3505(a) and (b). See *United States v. Messina Builders and Contractors Co.*, No. 84-0668-CV-W-9 (W.D. Mo. Oct. 11, 1985); *United States v. American Bank & Trust*, No. 84-5624 (E.D. Pa. Aug. 9, 1985); *United States v. Hunter Eng'rs & Constructors*, No. 83-1305 (D. Hawaii Sept. 6, 1984); *United States v. United Cal. Bank*, No. C-80-3422-WAI (N.D. Cal. Feb. 14, 1985). But see *United States v. National Acceptance Co. of America*, 603 F. Supp. 1351, 1353 (E.D. Mich. 1985) (rejecting *Associates Commercial Corp.*, and holding that the government may sue to collect a lender's liability under section 3505 without giving section 6303(a) notice).

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words of the statute as the primary guide to its interpretation requires an appreciation of the general purpose of the legislation so that literalism does not frustrate that purpose." *Schiaffo v. Helstoski*, 492 F.2d 413, 428 (3d Cir. 1974). A court must, therefore, look beyond the express language of a statute to give force to Congressional intent in two circumstances: "where the/statutory language is ambiguous; and where a literal interpretation would thwart the purpose of the overall statutory scheme or lead to an absurd result." *International Tel. & Tel. Corp. v. General Tel. & Elecs. Corp.*, 518 F.2d 913, 917-18 (9th cir. 1975); see also *Government of the Virgin Islands v. Berry*, 604 F.2d 221, 225 (3d Cir. 1979) ("All laws should receive a sensible construction. General terms should be so limited in their application as not to lead to . . . an absurd consequence. . . . The reason of the law in such cases should prevail over its letter.") (quoting *United States v. Kirby*, 74 U.S. (7 Wall.) 482, 486-87 (1868)). And any construction of a particular statute that would render all or part of the statutory scheme a "dead letter" is disfavored and to be avoided. See *Commissioner v. Bilder*, 289 F.2d 291, 298 (3d Cir. 1961), *rev'd on other grounds*, 369 U.S. 499 (1962).

A.

First, unlike the Seventh Circuit, we find the "plain meaning" of the statute less than wholly unambiguous. Section 6303(a) not only requires the government to "give notice to each person liable for the amount of the tax," it also requires notice of a particular kind: i.e., one "stating the amount and demanding payment thereof." In other words, a section 6303(a) notice consists of two discrete elements: (i) notice of the amount that has been assessed and (ii) a demand that the individual receiving the notice presently satisfy that assessment.

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Thus, the plain language of the statute envisions a notice not unlike a typical creditor's dunning letter, providing the individual receiving it with one last opportunity to pay the taxes before the government invokes the full panoply of its administrative collection powers. See generally M. Saltzman, *IRS Practice and Procedure* ¶ 14.01 (1981) (comparing tax collection with debt collection under the Uniform Commercial Code); see also *id.* ¶ 14.03 (describing the processing of tax collection cases); McGregor & Davenport, *Collection of Delinquent Federal Taxes*, 28 S. Cal. Tax Inst. 589, 761-82 (1976) (describing the process of collecting delinquent withholding taxes) [hereinafter cited as McGregor & Davenport, *Collection of Delinquent Federal Taxes*].

In sharp contrast to this type of notice is that contemplated by Jersey Shore and required by the Seventh Circuit. After *Associates Commercial Corp.*, the government must provide third parties like Jersey Shore with a copy of the notice of assessment and demand for payment sent to employers like Pennmount within sixty days of the assessment of such taxes. But such a notice serves quite a different purpose than that described above. First, it does not demand payment from the third party receiving the notice; nor does it even indicate the likelihood that the government will, at some time prior to the expiration of the applicable statute of limitations, look to that third party for payment. Similarly, such a "notice" will only fortuitously reflect the third party's potential liability, given both the differences between the taxes for which the employer and third party are liable and the limitations on liability contained within section 3505 itself. For example, the third party's liability is limited to those taxes required to be deducted and withheld from the employees' wages; it "is not liable for the employer's portion of payroll taxes." S. Rep. No. 1708,

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at 23; H.R. Rep. No. 1884, at 21. The notice and demand sent to the employer, however, does include these amounts. Thus, it overstates the third party's potential liability. Similarly, under section 3505(b), the third party's liability is limited to twenty-five percent of the money lent, which may or may not equal the amount assessed against the employer. And unless the time period in which the third party paid net wages directly corresponds precisely with that reflected in the assessment, the third party's liability under section 3505(a) will not equal that shown on the notice sent to the employer.

Accordingly, we find that section 6303(a) can plausibly be read to support the position of both the government and Jersey Shore, thus justifying our resort to its legislative history and prior judicial treatment to determine its proper construction. In fact, to the extent we find the "plain meaning" of the statute controlling, we find the government's construction of the statute the more natural and logical reading of the language: i.e., section 6303(a) requires notice only to those individuals against whom the taxes have been assessed. *See Guide to the Internal Revenue Code of 1954*, 1955 U.S. Code Cong. & Ad. News 1183, 1621 ("Subsequent to a valid assessment of any tax liability, . . . the Secretary . . . must, as soon as practicable, and within 60 days, after the making of the assessment serve a notice on the *delinquent taxpayer* stating the amount due and demanding payment thereof.") (emphasis added; footnote omitted); Andrews, *The Use of the Injunction as a Remedy for an Invalid Federal Tax Assessment*, 40 Tax L. Rev. 653, 658 (1985) ("As soon as practicable, and within 60 days after making the assessment, the Service is required to give the *taxpayer* notice of the unpaid amount and demand for its payment . . .") (emphasis added).

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B.

Under the Internal Revenue Code of 1939, the predecessor statute to section 6303(a) explicitly applied only to the collection efforts of the tax Collector, who by statute was authorized to collect taxes solely by administrative means, such as levying on the taxpayer's property. I.R.C. § 3655 (1952).³ By contrast, the Commissioner of Internal Revenue was authorized to bring civil suits to collect taxes owed. *Id.* § 3740. And it was long settled that the government's failure to assess its taxes did not preclude it from exercising its common-law right to sue for the taxes. *See, e.g., Macatee, Inc. v. United States*, 214 F.2d 717, 719-20 (5th Cir. 1954).⁴ It was equally well settled that where the government had assessed the taxes but failed to provide the taxpayer with notice of that assessment, it could still proceed by suit to collect the taxes owed. *United States v. Erie Forge Co.*, 191 F.2d 627 (3d Cir. 1951), *cert. denied*, 343 U.S. 930 (1952); *Jenkins v. Smith*, 99 F.2d 827 (2d Cir. 1938); *see also Marvel v. United States*, 719 F.2d 1507, 1513-14 (10th Cir. 1983) (alternative holding).

Where the government intends to proceed administratively to collect the taxes due, the need for the notice provided by section 6303(a) and its

3. Section 3655 provided, in pertinent part, that:

Where it is not otherwise provided, the collector shall within ten days after receiving any list of taxes from the Commissioner, give notice to each person liable to pay any taxes stated therein, . . . stating the amount of such taxes and demanding payment thereof.

4. The government's right to bring suit in this fashion was based simply on its common law right to sue on a debt, which exists independently of any statute. *See, e.g., Dollar Savings Bank v. United States*, 86 U.S. (19 Wall.) 227, 239-40 (1874); *Damsky v. Zavatt*, 289 F.2d 46, 51 (2d Cir. 1946) (Friendly, J.).

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predecessor statutes is readily apparent. The 1939 and 1954 Codes both provide that upon assessment and demand, all of the taxpayer's property, both real and personal, becomes subject to a lien in favor of the United States. I.R.C. §§ 6321, 6322 (1982); I.R.C. §§ 3670, 3671 (1952). If the taxpayer neglects or refuses to pay the taxes within ten days after notice and demand, the government may levy on or distrain any property belonging to the taxpayer on which a tax lien exists. I.R.C. § 6331(a), (b) (1982); I.R.C. §§ 3690, 3692, 3700 (1952). And after levying on or distraining the taxpayer's property, the government may sell it to satisfy the taxes owed. I.R.C. §§ 6331(b), 6335 (1982); I.R.C. §§ 3693, 3695(a)-(b), 3712 (1952). Thus, given the scope of the government's power to collect summarily the taxes owed under this statutory scheme, the notice required by sections 3655 and 6303(a) plays an important role: "[t]he purpose of requiring such a notice and demand is for the protection of the taxpayer." *Macatee, Inc.*, 214 F.2d at 719.

Where, as under section 3505,⁵ the government cannot proceed administratively, the need for notice under section 6303(a) is not nearly so self-evident. If the government cannot assess the third party's

5. Unlike its treatment of various other third-party liabilities, Congress did not authorize the Internal Revenue Service to assess separately third parties liable under section 3505, which would have empowered the government to proceed administratively. *Cf.*, e.g., I.R.C. § 6671(a) (1982) (providing that liability under section 6672 is to be "assessed and collected in the same manner as taxes"). Rather, Congress apparently intended that liabilities under section 3505 be collected in civil proceedings only.

In the event a payor does not voluntarily satisfy the liability imposed by section 3505(a), the United States may collect such liability by appropriate civil proceeding.

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liability, it cannot employ its summary collection methods against that party. Thus, such a third party is in no danger of having his property immediately seized or attached to satisfy the obligation. In a civil action, then, service of the government's complaint provides the party with all the notice and protection required; thus, the language "each person liable for the unpaid tax," then, refers only to those parties against whom the taxes have been assessed, and against whom the government can proceed administratively.

The Seventh Circuit, however, rejected any interpretation of section 6303(a) that differentiated between the manner in which the government attempts to collect the taxes owed:

Section 6303(a) itself does not indicate that the right to notice is dependent upon which tax collection option the government uses. Section 6303(a) requires notice of the assessment of unpaid taxes in order to protect the person liable for paying the taxes, and this rationale applies regardless of which collection mechanism is used.

721 F.2d at 1100 (citations omitted). In so doing, it distinguished those cases beginning with *Jenkins v. Smith*, 99 F.2d 827 (2d Cir. 1938) (per curiam), that stood for the proposition that the government's failure to give the notice required by section 6303(a) and its

In the event a supplier of funds does not voluntarily satisfy the liability imposed by section 3505(b), the United States may collect such liability by appropriate civil proceeding.

H.R. Rep. No. 1884, at 65-66; see also *United States v. First Nat. Bank*, 652 F.2d 882, 889 (9th Cir. 1981) (holding that liability under section 3505 cannot be separately assessed); *United States v. Dixieline Fin.*, 594 F.2d 1311, 1313 (9th Cir. 1979) (*id.*).

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predecessor statutes barred only the its right to collect the taxes administratively. It based this conclusion on what it apparently considered to be a critical organizational change in the statutory scheme enacted in 1954:

Jenkins and its progeny do not support the government's position. Section 1545 [a predecessor to sections 3655 and 6303(a)] was part of a statutory scheme quite different from that of which Section 6303(a) is now a part. Under the earlier scheme, the tax Collector had no authority to collect taxes by means of a civil proceeding, whereas under the Internal Revenue Code of which Section 6303 is a part, the Secretary of the Treasury . . . may collect the unpaid tax by levy (§ 6331) or by civil proceeding (§ 7401). . . . By necessary implication, then, where, as here, the same official . . . has power both to collect by levy and to authorize civil collection proceedings, . . . the failure to provide [the] statutorily required notice bars both recovery methods.

Id. As we read the court's opinion, then, the court focussed primarily upon the official in whom the power to collect the taxes had been lodged, rather than on the means by which that official sought to collect them.

After an examination of the administrative and legislative history leading up to the enactment of the Internal Revenue Code of 1954, we find that the Seventh Circuit misconceived the effect of any organizational changes wrought by its enactment. Consideration of the relationship between section 6303(a) of the 1954 Code and its predecessor statutes, combined with an appreciation of the organizational changes effected by President Truman prior to the enactment of the 1954 Code, leads us to conclude that

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the critical variable is the manner in which the government seeks to collect the taxes, not the official entrusted with that power. Thus, section 6303(a) requires notice only to those individuals against whom the government can proceed administratively.

First, the Committee Reports accompanying section 6303(a) indicate that Congress intended to make only "two changes from existing law," neither of which affects who is entitled to notice of an assessment. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A405-06, *reprinted in* 1954 U.S. Code Cong. & Ad. News 4017, 4553; S. Rep. No. 1622, 83d Cong. 2d Sess. 574, *reprinted in* 1954 U.S. Code Cong. & Ad. News 4621, 5222-23.⁶

Second, the organizational changes that the court placed so much weight on in *Associates Commercial Corp.* resulted not from Congressional action with respect to the 1954 Code, but from executive action under the 1939 Code. The current organization of the Internal Revenue Service stems from two reorganization plans promulgated by President Truman in 1950 and 1952, which Congress subsequently incorporated by reference when it enacted the 1954 Code. I.R.C. § 7804 (1982); *see also* 4 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶ 110.1, at 110-2 to -3 (1981); 9 J. Mertens, *The Law of Federal Income Taxation* § 49.02 (rev. ed. 1982). For example, the power to collect taxes both administratively and by means of a civil proceeding was first vested in the Secretary of the Treasury under

6. Specifically, Congress intended that notice and demand be given as soon as practical but no later than sixty days, rather than within ten days after receipt by the Collector of the Commissioner's certified list of assessments; and that, except in the case of a jeopardy assessment, payment was not to be demanded prior to the last date prescribed by law for the payment of the tax.

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the *Internal Revenue Code of 1939* by Reorg. Plan No. 26 of 1950, 15 Fed. Reg. 4935 (1950), reprinted in 5 U.S.C.A. app. at 274-75 (West 1967) [hereinafter cited as Reorg. Plan No. 26]. Similarly, the office of the Collector was abolished not by the enactment of the 1954 Code, but by the Reorg. Plan No. 1 of 1952, 17 Fed. Reg. 2243, reprinted in 5 U.S.C.A. app. at 280-81 (West 1967) [hereinafter cited as Reorg. Plan No. 1].

In neither case is there any indication that the President intended any change with respect to who was to receive notice of an assessment under the 1939 Code. Rather, the reorganizations had two primary goals: first, to increase the efficiency of the Department of the Treasury and the Internal Revenue Service; and second, to assure the honest and impartial administration of the internal revenue acts. See Message of the President, Reorg. Plan No. 26, 5 U.S.C.A. app. at 275 ("the reorganizations contained [herein are] essential to clarification of the lines of authority and responsibility in the executive branch"); Message of the President, Reorg. Plan No. 1, 5 U.S.C.A. app. at 281 ("A comprehensive reorganization of [the Internal Revenue Service] is necessary both to increase the efficiency of its operations and to provide better machinery for assuring honest and impartial administration of the [tax] laws."). In fact, to the limited extent that the administrative history speaks to this issue, it indicates an intent not to change the law substantively. See, e.g., Bureau of Internal Revenue, Operations Reorganization Order No. 3, 17 Fed. Reg. 8126 (1952) (delegating to each Director of Internal Revenue all functions relating to the assessment and collection of taxes and the accountability therefore of the predecessor office of the office of Collector of Internal Revenue in order to preserve the right to maintain suit for the refund of taxes); see also T.D. 5900, 17 Fed. Reg. 4464 (1952).

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Under these circumstances, we find that Congress did not intend to change the law with respect to who must receive notice when it enacted section 6303(a). Congress was fully aware of the changes wrought by Reorg. Plan No. 26 and Reorg. Plan No. 1 when it enacted the 1954 Code. It only follows that the Congress would adapt the language of the Code to fit the existing organization of the Department of the Treasury and the Internal Revenue Service. Thus, absent any legislative history to the contrary, we find that section 6303(a), like its predecessor statute under the the 1939 Code, only requires notice to those individuals against whom the government can proceed administratively. As a result, the government's failure to provide Jersey Shore with a copy of the notice of assessment and demand for payment sent to Pennmount does not bar its suit to collect the Bank's liability under section 3505.

C.

Careful consideration of the substantive requirement of section 3505 further buttresses our conclusion that section 6303(a) does not require notice to parties like Jersey Shore. In construing section 6303(a) to require notice to third parties like Jersey Shore, the Seventh Circuit was apparently concerned that unless such notice be given, third parties like Jersey Shore would have no reason to suspect that they may be liable under section 3505, to their ultimate prejudice. See 721 F.2d at 1099-1100. A similar concern has been voiced by other courts that have addressed this question. See, e.g., *United States v. American Bank & Trust*, No. 84-5624, slip op. at 4-5 (E.D. Pa. Aug. 9, 1985) (observing that "any potential burden [on the government] is outweighed by the possibility of prejudice to the lender not receiving notice"); *United States v. Associates Commercial*

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Corp., 548 F. Supp. 171, 174 (N.D. Ill. 1982).

However, in light of the burden of proof placed upon the government by section 3505, we find this concern to be generally unfounded. By definition, section 3505 liability only arises if the the third party (i) has actual knowledge that the employer does not intend to or will not pay over the taxes the taxes required to be withheld, or (ii) is itself directly paying net wages. In either situation, the third party is, of necessity, actually or constructively aware of its *potential* liability for the the taxes required to be deducted and withheld. Viewed in this light, the notice required by *Associates Commercial Corp.* communicates no additional information; thus, it serves no useful purpose. *Cf. United States v. Dixieline Fin.*, 594 F.2d 1311, 1312-13 (9th Cir. 1979) (holding that no independent assessment is required under section 3505(b), because it would serve no useful purpose). Quite to the contrary, construing section 6303(a) as the Seventh Circuit did simply adds an additional formalistic requirement for the imposition of section 3505 liability--a requirement upon which parties liable under section 3505 can rely, thereby thwarting Congress' intent to recover the unpaid withholding taxes from such persons.

Although we do not intend to downplay the potential burden resulting from our construction of section 6303(a), we find the legislative history of section 3505 quite instructive on the question of prejudice to parties like Jersey Shore. When it enacted section 3505, Congress expressly considered the steps that third parties should take to protect themselves:

[S]ureties can protect themselves against any losses attributable to withholding taxes by including this risk of liability in establishing their premiums, and lenders by their including

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the amounts in their loans and taking adequate security.

S. Rep. No. 1708, at 23; H.R. Rep. No. 1884, at 22. In other words, Congress envisioned a system in which third parties would take their potential liability under section 3505 into consideration at the time they entered into the transaction exposing them to liability under the statute.

Moreover, by taking steps to protect themselves at the inception of such transactions, rather than at the time the government assesses the taxes against an employer like Pennmount,

losses now borne by the Government will fall (as it should) on the employers in the form of a larger bonding, or other fee or cost they must pay. Since the withholding taxes are, in true character, a part of the wages, it seems only appropriate that this cost be borne by the employers in the same manner as is true of the net wage costs.

S. Rep. No. 1708, at 23; H.R. Rep. No. 1884, at 22. Thus, our construction of the two statutes furthers Congress' intent with respect to section 3505, without substantially prejudicing the rights of third parties like Jersey Shore.

D.

The government also argues that requiring section 6303(a) notice for third parties subject to section 3505 liability will, in effect, render the latter statute a "dead letter," thereby thwarting Congress' intent to provide an additional source from which to recover unpaid withholding taxes. In *Associates Commercial Corp.*, the Seventh Circuit rejected this argument as "highly speculative and unsupported by any convincing

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statistics." 721 F.2d at 1099. We disagree; in light of the manner such taxes are collected, available statistics and common sense both dictate that such a requirement would impose a prohibitory investigative burden on the government.

First, given the number of returns involved, the government cannot be expected to initiate an investigation each time a taxpayer files a return but fails to pay his full tax liability. For example, in 1973 employers filed 2.3 million withholding tax returns with unpaid balances. McGregor & Davenport, *Collection of Delinquent Federal Taxes*, at 768. Similarly, in that same year individual taxpayers filed 3.8 million returns with unpaid liabilities. *Id.* at 601.

Second, even assuming that the resources were available, an immediate full-scale investigation in all cases involving delinquent tax payments would constitute a significant waste of government resources. Under ordinary circumstances, the problem can be dealt with more efficiently by sending the taxpayer a series of notices, as would be done by any other creditor in a similar situation. For example, in 1980 the Internal Revenue Service sent individual taxpayers 7.05 million first notices for balances due, but only 2.3 million TDA's or Taxpayer Delinquent Accounts (which result only after attempts to collect by notice fail) were issued for *all* types of returns, including individual returns. Internal Revenue Service, *Quarterly Statistical Report*, at 20-21 (Dec. 1980); see also McGregor & Davenport, *Collection of Delinquent Federal Taxes*, at 602-05 & n.22 (discussing TDA's). Similarly, of the 2.3 million unpaid withholding returns filed in 1973, approximately 0.8 million were paid in response to such notices, and only 1.5 million TDA's were issued. *Id.* at 768-69.

Finally, both Jersey Shore and the district court implicitly recognize this problem by suggesting that

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the government should delay assessing the employer-taxpayer for up to three years, thereby permitting it to identify third parties who might be liable for the taxes. This suggestion, however, would seriously jeopardize the government's interest in collecting the taxes from the employer, because such a practice would enable other creditors to obtain prior liens against the employer's property. As a result, this would seriously undermine the fundamental "purpose of the federal tax lien statute to insure prompt and certain collection of taxes due the United States from tax delinquents." *United States v. Security Trust & Savings Bank*, 340 U.S. 47, 51 (1950).

Under these circumstances, we are forced to conclude that liability under section 3505 would be rendered a substantial nullity if, as an absolute prerequisite for collection, the government is forced to give third parties such as Jersey Shore notice of its assessment against the taxpayer within sixty days.

V.

Accordingly, the judgment of the district court will be reversed and the cause remanded to the district court for further proceedings consistent with this opinion.

WEIS, Circuit Judge, dissenting.

The issue in this case is not complicated -- it is simply whether we read the Internal Revenue Code as Congress wrote it or as the Internal Revenue Service would like us to amend it. In clear terms, § 6303(a) states that the Secretary of Treasury "shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax."

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The reference to "each person liable" in § 6303 is not in the least ambiguous. In the case at hand, the government contends that defendant is liable for the tax. Therefore, it seems inescapable that defendant should have been given notice.

The IRS wishes us to redraft that section so that it requires notice only to those individuals against whom taxes have been assessed. The reasons offered for this revision have some logic and would possibly ease administrative burdens on the government, but the arguments are directed to the wrong forum. They should be presented to Congress, not the courts.

In *Iselin v. United States*, 270 U.S. 245, 251 (1926), the Supreme Court said that courts should not revise a statute so that "what was omitted, presumably by inadvertence, may be included within its scope. To supply omissions transcends the judicial function."

The courts' limited role was reemphasized in *TVA v. Hill*, 437 U.S. 153 (1978). Once "Congress has spoken in the plainest of words" and "the meaning of an enactment is discerned . . . the judicial process comes to an end. We do not sit as a committee of review, nor are we vested with the power of veto." Courts may not "pre-empt congressional action by judicially decreeing what accords with 'common sense and the public weal.' Our Constitution vests such responsibilities in the political branches." *Id.* at 194-95.

In this case, I cannot even say with assurance that the addition to the statute that the IRS proposes was inadvertently omitted. Certainly, the legislative history of § 6303 provides no basis for such a belief. Moreover, the legislative history of § 3505 does not suggest that notice should not be provided lenders who may be secondarily liable. "Congressional silence, no matter how 'clanging' cannot override the words of the

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statute." *Sedima v. Imrex Co., Inc.*, 53 U.S.L.W. 5034, 5038 n.13 (June 25, 1985).

It bears mentioning that the dispute here is not about a meaningless formality. The assessment of taxes against Pennmount had the effect of enlarging the statute of limitations against defendant bank for six years. 26 U.S.C. § 6502(a)(1). *United States v. Associates Commercial Corp.*, 721 F.2d 1094, 1097 (7th Cir. 1983). The likelihood of prejudice because of the loss or destruction of records by one secondarily liable is real and substantial. *United States v. Associates Commercial Corp.*, 548 F. Supp. 171, 174 (N.D. Ill. 1982).

The net effect of the Code revision urged by the IRS is to give less procedural protection to one secondarily liable than to the primary obligor. The notice of assessment will alert the taxpayer directly liable to the lengthened statute of limitations. He may then preserve pertinent records, arrange for payment, compromise, or take other steps in his own best interests. Without notice of the assessment, however, the party liable under § 3505 may not be alerted to his continuing exposure and concomitant risks. I am not convinced that Congress intended such an anomalous result.

Two courts of appeals have already rejected the precise arguments advanced by the government in this case. See *United States v. Merchants Nat. Bank of Mobile*, 772 F.2d 1522 (11th Cir. 1985) and *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983). I find the IRS position no more persuasive than did those courts, and I join their insistence that the government adhere to the clear mandate of the statute.

The Internal Revenue Code has never been noted for facile comprehension, and dogged plodding

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through it uncovers little of cheer to any taxpayer. The challenged clause is an oasis of clarity in that desert of dull, deadly detail, but even here the IRS, would pile a sandy gloss on the language to obscure the obvious. In *Temple University v. United States*, 769 F.2d 126, 139 (3d Cir. 1985), I saw "no need for the court to be unduly solicitous about curing statutory deficiencies to aid the IRS in doubtful cases." That protest applies even more here where the government's case is less meritorious.

I dissent.

A True Copy:

Teste:

*Clerk of the United States Court of Appeals
for the Third Circuit*

APPENDIX B—DENIAL OF PETITION FOR REHEARING

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 85-5263

UNITED STATES OF AMERICA,

Appellant

v.

JERSEY SHORE STATE BANK,

Appellee

(Civil No. 83-1879 - M.D.Pa. - Scranton)

SUR PETITION FOR REHEARING

PRESENT: ALDISERT, *Chief Judge*, SEITZ, ADAMS, GIBBONS, HUNTER, WEIS, GARTH, HIGGINBOTHAM, SLOVITER, BECKER, STAPLETON, MANSMANN, and ROSENN, *Circuit Judges*.

The petition for rehearing filed by appellee in the above entitled case having been submitted to the judges who participated in the decision of this court and to all other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having

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voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,

s/ Seitz

Circuit Judge

DATED: February 4, 1986

**APPENDIX C—ORDER OF UNITED STATES DISTRICT
COURT FOR THE MIDDLE DISTRICT OF PENNSYLVANIA**

UNITED STATES DISTRICT COURT FOR THE MIDDLE
DISTRICT OF PENNSYLVANIA

Civil No. 83-1879

Complaint Filed 12/30/83

(Judge Muir)

UNITED STATES OF AMERICA,

Plaintiff

vs.

JERSEY SHORE STATE BANK,

Defendant

ORDER

March 20, 1985

THE BACKGROUND OF THIS ORDER IS AS FOLLOWS:

The United States of America filed this lawsuit against the Defendant, Jersey Shore State Bank (Bank), seeking payment of Federal Insurance Contribution Act (FICA) taxes which were withheld from the wages of employees of Pennmount, Industries, Inc. (Pennmount) pursuant to 26 U.S.C. §§ 3505(a) and (b) of the Internal Revenue Code of 1954. Presently pending before this Court are the parties' cross-motions for summary judgment. These motions are now ripe for this Court's consideration.

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The undisputed facts in this case are as follows. The Bank is an authorized Pennsylvania banking institution with its main office at 115 South Main Street, Jersey Shore, Pennsylvania. Pennmount Industries, Inc. was a corporation located in Lock Haven, Pennsylvania engaged in the manufacture of wooden tables and chairs. In February of 1976, Pennmount opened a checking account at the Bank and the Bank made Pennmount a working capital loan of \$20,000. Between February of 1976 and July of 1977, the Bank provided Pennmount with additional loans which totalled \$270,000, secured by mortgages on Pennmount property and by specific receivables of Pennmount. Beginning with the fourth quarter of 1977, and continuing through the first quarter of 1980, Pennmount failed to pay over to the United States of America federal income taxes and FICA taxes which it withheld from the wages of its employees. The parties do not dispute the validity of these taxes.

In June of 1977, Pennmount set up a separate checking account at the Bank, No. 154-261, which was only to be used for the deposit of withholding and FICA taxes. In July of 1977, Pennmount paid to the United States by certified check on the Bank part of the proceeds of a loan from the Bank in satisfaction of Pennmount's delinquent withholding and FICA taxes. Because the company was experiencing financial troubles, Pennmount began paying its employees in cash rather than by check during the latter part of 1977 until October 28, 1977. On that date, Pennmount began paying its employees by means of money orders issued by the Bank. From October 28, 1977 through January of 1979, Pennmount procured from the Bank a money order for each Pennmount employee in the amount of that employee's net wages. Pennmount paid for the money orders by a check to the bank for the total amount of the net payroll. These payroll payments by money order were made from a third bank account,

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No. 166-308, opened on October 26, 1978. In January of 1978, the tax account, No. 154-261, which Pennmount had established for the purpose of depositing withheld FICA taxes became overdrawn and remained overdrawn through September of 1979. Although checks were drawn payable to the Internal Revenue Service on that special account, the Bank did not pay those checks because the account lacked sufficient funds. In January of 1979, Pennmount ceased its manufacturing operations, and in order to preserve its security, the Bank began directly paying the wages of those Pennmount employees whose services were necessary to conserve the assets of the company. The Bank did not at that time pay to the United States any withholding or FICA taxes for which Pennmount had been delinquent since the first calendar quarter of 1979.

While the Bank concedes that it is liable for Pennmount's withholding and FICA taxes beginning in 1979, the parties dispute whether the Bank's involvement in the payment of wages to Pennmount's employees from October 28, 1977 to December 31, 1979 renders it liable under either 26 U.S.C. § 3505(a) or (b) for the withholding and FICA taxes Pennmount was required to pay to the United States. Section 3505(a) makes a third party personally liable in an amount equal to unpaid withholding and FICA taxes where that third party pays wages directly, or through an agent, to a taxpayer's employees. 26 U.S.C. § 3505(a) provides as follows:

Direct payment by third parties.—For purposes of sections 3102, 3202, 3402, and 3403, if a lender, surety, or other person, who is not an employer under such sections with respect to an employee or group of employees, pays wages directly to such an employee or group of employees, employed by

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one or more employers, or to an agent on behalf of such employee or employees, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer.

The companion provision to Section 3505(a) is Section 3505(b) which imposes personal liability on third parties who supply funds to an employer for the purpose of paying wages knowing that the employer does not intend to or will be unable to pay withholding taxes to the Government. 26 U.S.C. § 3505(b) provides:

Personal liability where funds are supplied.—If a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required by this subtitle to be deducted and withheld by such employer from such wages, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer with respect to such wages. However, the liability of such lender, surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied to or for the account of such employer for such purpose.

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On October 30, 1984, the United States moved for summary judgment on Count 1 of the complaint which states a claim against the Bank under 26 U.S.C. § 3505(a) which in brief relates to wages paid directly to employees by a third person. The United States argues that the undisputed facts show that by issuing money orders in the net amount of Pennmount employee's wages from October 1, 1977 through December 31, 1978, the Bank directly paid the wages of Pennmount employees so as to be liable for Pennmount's withholding and FICA taxes for that period under 26 U.S.C. § 3505(a) in the amount of \$15,011.57 plus interest. The Bank filed a brief in opposition to which the United States filed a reply. On October 31, 1984, the Bank filed its cross-motion for summary judgment in which it requested that it be granted summary judgment on both counts of the complaint because the undisputed facts show that the United States never gave the Bank or Pennmount Industries notice of the filing of an assessment against either the Bank or Pennmount Industries and that that failure was in contravention of the statutory notice requirement set forth in 26 U.S.C. § 6303(a). Failure to comply with the notice provisions of 26 U.S.C. § 6303(a), the Bank argues, precludes the United States from maintaining this action against the Bank. We will first address the Defendants' cross-motion for summary judgment because, if it is granted, it will dispose of this lawsuit.

FICA and employment withholding taxes fall within Subtitle C of the Internal Revenue Code governing employment taxes. Congress added to Subtitle C what are now §§ 5303(a) and 5303(b) in order to provide the IRS a remedy against third persons, such as creditors and banks who directly or indirectly pay the net wages of a taxpayers' employees. Subtitle C does not set out a special procedure which the IRS must follow in order to affix tax liability pursuant to §§ 5303(a) and 5303(b) but instead relies on Subtitle F of the Internal Revenue Code which generally governs procedure

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and administration of tax-related prosecutions. Within Chapter 64 of Subtitle F, 26 U.S.C. § 6303 sets forth the procedure by which notice and demand for a tax shall be made. That section provides as follows:

(a) General Rule.—Where it is not otherwise provided by this title, the Secretary or his delegate shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be left at the dwelling of usual place of business of such person, or shall be sent by mail to such person's last known address.

Jersey Shore argues that because more than five (5) years elapsed between the initial date of notice of the filing of the tax lien assessment against Pennmount and the institution of the present action against the Bank, section 6303(a) has been violated. When Pennmount failed to pay employee withholding and FICA taxes from the beginning of 1977 through the first quarter of 1980, the Government made tax lien assessments against Pennmount. The Government gave Pennmount notice of the filing of its first tax lien against Pennmount on June 22, 1978. The Government admits that it did not provide the Bank with any notice of filing of this tax lien or any other subsequent tax lien assessments against Pennmount until the Government filed this lawsuit against the Bank on December 30, 1983. What this Court must determine is whether the Government's failure to give the Bank prior notice of its potential liability for the assessment made against Pennmount violates § 6303(a) and, if so, what are the consequences of that violation.

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Relying on the recent case of *United States vs. Associates Commercial Corporation*, 721 F.2d 1094 (7th Cir. 1983), the Bank argues that a lender cannot be held liable under 26 U.S.C. § 3505(b) where the Government fails to provide the lender with notice of a filing of a tax lien assessment against the company to which the lender has made loans or extended credit. The *Associates Commercial* Court held that § 6303(a) mandates notice to a lender subject to § 3503(b) liability, and that failure to provide notice pursuant to § 6303(a) bars a subsequently filed civil action. *Id.* at 1098. The Court pointed out that because no specific enforcement procedure applied to proceedings under § 3505(b), those sections of the Internal Revenue Code which created liability such as § 3505(b) had to be read and interpreted in conjunction with those Code Sections setting forth the procedure for enforcement of such liabilities, including the notice requirement of § 6303(a). We agree with the conclusion of the Seventh Circuit Court of Appeals that § 6303(a) is the general notice provision for all liability created under the Internal Revenue Code, including § 3505(b).

The United States of America, in its memorandum in opposition to Jersey Shore's motion for summary judgment, argues that the notice provision of § 6303(a) is only a part of the administrative collection process and not a prerequisite to the collection of taxes by means of civil lawsuit. However, the United States acknowledges that an assessment is "simply a bookkeeping notation . . . made when the Secretary [of the Treasury] or his delegate establishes an account against the taxpayer on the tax rolls." *Laing vs. United States*, 423 U.S. 161, 170 n. 13 (1976). See 26 U.S.C. § 6203. Once an assessment is made, an automatic lien arises against the taxpayers' property by statute. 26 U.S.C. §§ 6321 and 6322. Once an assessment has been made, the IRS has the power to collect that tax using certain summary methods

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of collection which do not necessitate court action. *See*, United States vs. Rodges, 51 U.S.L.W. 4621, 4623 (May 31, 1983). But before the IRS can levy on property on which an assessment has been made, the United States admits that the taxpayer must first be notified. *See* Memorandum in Opposition to Defendants' Motion for Summary Judgment, page 12. 26 U.S.C. § 6331(a) and (b). Furthermore, it is undisputed that the function of the notice and demand requirement in § 6303(a) is to protect the taxpayer. *Macatee, Inc. vs. United States*, 214 F.2d 717, 719 (5th Cir. 1954). Yet, the United States argues that § 6303(a) requires notice only to those parties whose names appear on the assessment list. Such an interpretation runs afoul of the plain language of the statute which specifically requires that notice be given *each person liable for the unpaid tax*, stating the amount due and demanding payment thereof. While the United States properly contends that § 6303(a) does not mandate perfect technical compliance so that belated or constructive notice of the assessment may suffice to render a third party liable, in the case before us absolutely no notice of the assessment was received by the Bank for almost six years until this civil suit was filed in 1983. No claim for constructive notice is made.

The Government also argues that failure to provide notice to the Bank under 26 U.S.C. § 6303(a) does not preclude this litigation because it is simply not practical to require the IRS to notify the person potentially liable for a tax within 60 days of assessment. Reading such a requirement into section 6303(a), the Government argues, will impose an impossible requirement on the IRS which will impose a great economic and investigatory burden, requiring the IRS to identify potentially liable third parties. The IRS takes the position that requiring the IRS to notify potentially liable third parties will undermine the purpose of § 3503(b) under which Congress intended to create an additional

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source for the recovery of unpaid withholding taxes. But as pointed out by the Bank, 26 U.S.C. § 6501(a) provides that the Government has three years from the time that a tax return is filed to impose an assessment. Therefore, the Government has three years to identify lenders who are potentially liable for an employer's withholding and FICA taxes and to file an appropriate assessment before the 60 day notice period begins to run. Hence, we are not persuaded that requiring the IRS to comply with 26 U.S.C. § 6303(a) will unduly impede its ability to collect withholding and FICA taxes as Congress intended under § 3505(b). We also note that the notice provision of § 6303(a) is only one of the many limitations which Congress has placed on § 3505(b). Because section 3505(b) in effect imposes derivative liability on a lender for an employer's withholding and FICA taxes, it is all the more necessary to insure that lenders receive adequate, prompt notice of a potential claim against them by the Government. *United States vs. Associates Commercial Corp.*, 721 F.2d 1094, 1099 (7th Cir. 1983). We therefore conclude that instead of defeating Congress's intent, as the Government argues, applying the notice provisions of § 6303(a) to lenders subject to section 3505(b) liability gives effect to that intent. If Congress had intended that the notice provisions of 26 U.S.C. § 6303(a) not apply to persons whom the Government seeks to hold liable under 26 U.S.C. § 3505(b) then Congress would have created such an exception in the statute.

Lastly, the Government argues that even if section 6303(a) required the United States to give notice to the Bank of the assessment made against Pennmount, failure to give such notice does not impair the United States's right to sue the Bank under § 3505(b) for Pennmount's employee withholding and FICA taxes. But as noted by the Seventh Circuit Court of Appeals in *Associates Commercial*, section 6303(a) itself does not indicate that the right

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to notice is dependent on which tax collection option the Government uses. 721 F.2d 1094, 1100. Section 6303(a) requires notice of the assessment of unpaid taxes in order to protect the person liable for paying taxes from surprise without regard to the collection mechanism that the government employs. *Id.* Nor are we persuaded by the Government's argument that it has an independent common law right to collect a debt for tax liability independent of the assessment process for which no notice pursuant to § 6303(a) is required.

For the foregoing reasons, we will grant the motion of the Defendant Jersey Shore State Bank for summary judgment.

NOW, THEREFORE, IT IS ORDERED THAT:

1. The motion of the United States for summary judgment is hereby denied.
2. The motion of the Defendant Jersey Shore State Bank for summary judgment is hereby granted.
3. The Clerk of this Court shall enter judgment in favor of the Defendant Jersey Shore State Bank.
4. The Clerk of this Court shall close this file.

s/ Muir

MUIR, U.S. District Judge

Appendix C

UNITED STATES DISTRICT COURT FOR THE MIDDLE
DISTRICT OF PENNSYLVANIA

CIVIL NO. 83-1879

Complaint Filed 12/30/83
(Judge Muir)

UNITED STATES OF AMERICA,

Plaintiff

vs

JERSEY SHORE STATE BANK,

Defendant

JUDGMENT

The issues having been duly reviewed by the Honorable Malcolm Muir, United States District Judge, and a decision having been rendered this date thereon.

It is Ordered and Adjudged that judgment be and hereby is entered in favor of the Defendant Jersey Shore State Bank

Dated at Williamsport, Pennsylvania, this 20th day of March, 1985.

s/ Donald R. Berry

Donald R. Berry, Clerk of Court

By

s/ Barbara Plesce

Deputy Clerk

APPENDIX D—COMPLAINT WITH ATTACHMENTS

IN THE UNITED STATES DISTRICT COURT FOR THE
MIDDLE DISTRICT OF PENNSYLVANIA

CIVIL ACTION NO. 83-1879

UNITED STATES OF AMERICA,

Plaintiff

v.

JERSEY SHORE STATE BANK,

Defendant

COMPLAINT

The plaintiff, the United States of America, by its undersigned attorney the United States Attorney for the Middle District of Pennsylvania, for its cause of action complains and alleges as follows:

COUNT I

1. This action is begun under 26 U.S.C., Section 7401 at the direction of the Attorney General of the United States, with the authorization and sanction of the Chief Counsel of the Internal Revenue Service, a delegate of the Secretary of the Treasury.

2. This Court has jurisdiction over this action under 28 U.S.C. Sections 1340 and 1345, and 26 U.S.C., Section 7402.

3. The defendant, the Jersey Shore State Bank ('defendant')

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is a bank with offices at 115 South Main Street, Jersey Shore Pennsylvania 17745, within the jurisdiction of this Court.

4. The defendant is a bank which provided money to Pennmount Industries, Inc., (hereinafter referred to as Pennmount), a corporation engaged in the manufacture of wooden tables and chairs.

5. During the fourth quarter of 1977 through the first quarter of 1980, Pennmount failed to pay over to the United States of America federal income, and Federal Insurance Contribution Act ("FICA") taxes required to be withheld from the wages of Pennmount employees.

6. A delegate of the Secretary of the Treasury made assessments against Pennmount according to law for federal income taxes and FICA taxes required to be withheld and deducted from the wages of Pennmount employees for the quarters described in paragraph 5 of Count I as well as quarters not at issue in this lawsuit. Attachment A gives further information concerning these assessments. Despite notice of and demand for payment of these assessments there remains unpaid the sum of \$115,986.68 plus accruals owed by Pennmount.

7. Defendant paid wages directly to Pennmount employees during the fourth quarter of 1977 through the first quarter of 1980. Defendant did not deduct or withhold federal income taxes from these wages it paid directly to Pennmount's employees. Defendant did not deduct FICA taxes from these wages it paid directly to Pennmount's employees. Under 26 U.S.C., Section 3505(a) defendant is thus liable to the United States for taxes (plus interest) required to be deducted and withheld.

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8. Defendant had the ability, right, and legal authority to control the funds out of which it made payments of wages directly to Pennmount employees.

9. Under 26 U.S.C., Section 3505(a), defendant is liable to the United States of America for taxes and interest to June 30, 1981 in the amount of \$76,547.57 plus accrued interest until paid (or for such greater amount as determined by this Court).

WHEREFORE, the United States of America demands the following:

A. That this court grant a judgment against defendant under 26 U.S.C., Section 3505(a), in an amount equal to the taxes (plus interest) required to be deducted and withheld from the wages of Pennmounts' employees for the fourth quarter of 1977 through the first quarter of 1980.

B. That it be granted any other relief, including costs, that this Court may deem improper.

COUNT II

10. The plaintiff, United States of America reasserts the allegations described in paragraphs 1-6 of Count I of its complaint.

11. During the fourth quarter of 1977 through the first quarter of 1980, the defendant supplied funds to or for the account of Pennmount Industries, Inc., for the specific purpose of paying the wages of employees of Pennmount Industries, Inc.

12. Such funds were supplied with actual notice and knowledge that Pennmount Industries, Inc., did not intend to

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or would not be able to make timely payments or desposits of the amount of federal taxes required to be deducted and withheld by Pennmount Industries, Inc., from such wages.

IX

13. The defendant is obligated to the United States by virtue of the provisions of Section 3505(b) (26 U.S.C.) in the amount of \$72,069.00 representing twenty-five percent (25%) of the \$288,279.85 which was the amount supplied by it to Pennmount Industries, Inc., for the payment of wages during the period described in paragraph 11 of Count II.

WHEREFORE, the United States of America, demands the following:

(a) That this Court determine that the defendant, Jersey Shore State Bank, is indebted to the United States of America in the amount of \$72,069.00 plus interest as provided by law.

(b) That this Court grant judgment against the defendant in favor of the United States in the amount of \$72,069.00 plus interest as provided by law.

(c) That this court grant any other relief, including costs, that this court may deem proper.

DAVID DART QUEEN
United States Attorney

By: /s/ James W. Walker
Assistant United States Attorney

Appendix D

OF COUNSEL:

MARK G. GELLAR

Trial Attorney, Tax Division

U.S. Department of Justice

Washington, D.C. 20530

Telephone: (202) 724-6390

TAX PAYER: PENNMOUNT INDUSTRIES, INC.
 LOCK HAVEN, PA 17745
 EIN: 23-1944909

ATTACHMENT A

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ASSESSMENT

TAX PAYER EFFECT	TYPE OF TAX FROM NUMBER OF RETURNS	DATE	TAX	PENALTY	INTEREST	DATE OF NOTICE AND DEMAND	ACCRUED INTEREST TO 11-17-80	ACCRUED FAILURE TO PAY TO 11-17-80	BALANCE DUE 11-17-80	DATE NOTICE OF LIEN FILED
7612	941 WT/FICA	04-04-77	\$17,593.05	\$ 879.65 (2) 87.97 (3)	\$ 94.47	04-04-77	\$ 791.52	\$ 438.76	\$ 2,447.28	07/25/77 (6)
7703	941 WT/FICA	06-17-77	11,742.84	175.93 (4) 1,056.86 (1) 587.14 (2)	102.75	06-17-77	507.65	176.14	2,430.54	07/25/77 (6)
7706	941 WT/FICA	07-18-77	6,691.62	304.12 (1) 50.47 (3)	43.80	07-18-77	589.56	-0-	3,046.47	12/05/77 (6)
		07-18-77	5,061.33	37.58 (3)	24.08	07-18-77				
		08-22-77	5,482.78	19.55 (3)	14.03	08-22-77				
7712	941 WT/FICA	01-02-78	6,607.18			01-02-78	1,439.21	1,090.16	9,210.64	06/22/78 (6)
		01-23-78	6,635.01			01-23-78				
		02-13-78	6,795.43			02-13-78				
		05-08-78		66.07 (4)		05-08-78				
7803	941 WT/FICA	03-27-78	6,595.72			03-27-78	3,506.45	2,599.47	23,590.33	07/27/79 (6)
		05-08-78	4,904.18			05-08-78				
		05-29-78	5,803.49			05-29-78				
		08-14-78		49.04 (4)		08-14-78				
		10-16-78		58.03 (4)		10-16-78				
		12-11-78		65.95 (4)		12-11-78				
7806	941 WT/FICA	07-10-78	6,803.69			07-10-78	2,661.48	1,888.32	19,547.40	12/20/78 (6)
		07-24-78		68.03 (4)		07-24-78				
		08-14-78	5,123.65	230.65 (1) 25.62 (3)	19.16	08-14-78				
		09-18-78	2,588.20	12.94 (3)	10.21	09-18-78				
		10-09-78		28.32 (4)		10-09-78				
		10-16-78		25.88 (4)		10-16-78				
		10-30-78		51.25 (4)		10-30-78				

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TAX PAYER: PENNMOUNT INDUSTRIES, INC.
LOCK HAVEN, PA 17745
EIN: 23-1944909

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ASSESSMENT

TAX PERIOD	TYPE OF TAX FORM NUMBER OF RETURNS	DATE	TAX	PENALTY	INTEREST	DATE OF NOTICE AND DEMAND	ACCRUED INTEREST TO 11-17-80	ACCRUED FAILURE TO PAY TO 11-17-80	BALANCE DUE 11-17-80	DATE NOTICE OF LIEN FILED
7809	941 WT/FICA	09-18-78 10-16-78 11-13-78 11-20-78 12-18-78	\$2,832.54 3,465.79 \$34.65 (4) 5,996.10 59.96 (4)			09-18-78 10-16-78 11-13-78 11-20-78 12-18-78	\$2,117.42	\$1,506.82	\$16,021.28	03/26/79 (6)
7812	941 WT/FICA	01-08-79 01-29-79 02-19-79 03-12-79 03-19-79 10-01-79	3,926.66 4,394.64 5,257.78 39.26 (4) 52.57 (4) 43.94 (4)			01-08-79 01-29-79 02-19-79 03-12-79 03-19-79 10-01-79	2,127.12	1,419.17	17,269.34	10/26/79 (6)
7903	941 WT/FICA	03-26-79 05-07-79 05-28-79 04-16-79 05-14-79 07-30-79	2,844.52 1,179.88 1,365.06 28.23 (4) 11.79 (4) 13.65 (4)		\$.14	03-26-79 05-07-79 05-28-79 04-16-79 05-14-79 07-30-79	766.59	506.10	6,715.87	10/26/79 (6)
7906	941 WT/FICA	06-18-79 07-30-79 08-13-79 09-10-79	929.12 918.54 883.99 9.29 (4) 9.18 (4)		5.10 4.07	06-18-79 07-30-79 08-13-79 09-10-79	347.07	209.52	3,323.88	11/26/79 (6)

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TAX PAYER: PENNMOUNT INDUSTRIES, INC.
LOCK HAVEN, PA 17745
EIN: 23-1944909

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ASSESSMENT

TAX PERIOD	TYPE OF TAX FORM NUMBER OF RETURNS	DATE	TAX	PENALTY	INTEREST	DATE OF NOTICE AND DEMAND	ACCRUED INTEREST TO 11-17-80	ACCRUED FAILURE TO PAY TO 11-17-80	BALANCE DUE 11-17-80	DATE NOTICE OF LIEN FILED
7909	941 WT/FICA	09-24-79 10-22-79 11-12-79	\$ 865.27 1,331.65 881.02		\$5.60 7.75 4.05	09-24-79 10-22-79 11-12-79	\$ 341.53	\$ 189.00	\$ 3,633.87	02/26/80 (6)
7912	941 WT/FICA	10-24-79 01-28-80 02-18-80	896.96 825.56 796.61		5.80 5.61 6.99	10-24-79 01-28-80 02-18-80	241.42	117.85	2,896.80	10/02/80 (6)
8003	941 WT/FICA	03-31-80 04-21-80 05-26-80	840.32 1,545.61 943.86	\$37.81 (1) 8.40 (3) 69.55 (1) 15.46 (3)	12.82	03-31-80 04-21-80 05-26-80	229.23	116.54	3,859.56	10/02/80 (6)
8006	941 WT/FICA	06-23-80 07-14-80	907.50 911.88	40.84 (1) 9.08 (3)	11.46 8.68	06-23-80 07-14-80	67.60	36.38	1,993.42	11/06/80 (6)
									\$115,986.68	

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- (1) Delinquency Penalty Section 6651(a)(1), Internal Revenue Code of 1954
(2) Depositary Receipt Penalty Section 6656, Internal Revenue Code of 1954
(3) Failure to Pay Penalty, Section 6651(a)(2), Internal Revenue Code of 1954
(4) Bad Check Penalty Section 6657, Internal Revenue Code of 1954
(5) Accrued Failure to Pay Penalty - 1/2 of 1% per month through November 1980
(6) Prothonotary of Clinton County, Lock Haven, PA
(7) On or after November 17, 1980, interest accrual is \$32.82 per day.

APPENDIX E—ANSWER

UNITED STATES DISTRICT COURT FOR THE MIDDLE
DISTRICT OF PENNSYLVANIA

CIVIL NO. 83-1879

Complaint Filed 12/30/83

(Judge Muir)

UNITED STATES OF AMERICA,

Plaintiff

vs.

JERSEY SHORE STATE BANK,

Defendant

ANSWER

The defendant, Jersey Shore State Bank, by its counsel Martin A. Flayhart, Esquire, appears and answers the Complaint of the plaintiff as follows:

COUNT I**FIRST DEFENSE**

Defendant admits the allegations contained in paragraphs 1, 2 and 3 of the Complaint; admits the allegation contained in paragraph 4 of the Complaint to the extent that money provided by the defendant to Pennmount Industries, Inc. was provided

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as a commercial loan; alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraphs 5 and 6 of the Complaint; and denies each and every other allegation contained in Count I of the Complaint.

SECOND DEFENSE

The Complaint fails to state a claim against the defendant upon which relief can be granted. The plaintiff failed to provide the defendant with notice within sixty (60) days of the making of any assessment against Pennmount Industries, Inc. for nonpayment of federal withholding taxes and FICA taxes as required by 26 USC Section 6303.

THIRD DEFENSE

The plaintiff has waived its rights against the defendant by failing to diligently prosecute its claim against Pennmount Industries, Inc., the officers and directors of Pennmount Industries, Inc. and the defendant during the pendency of the bankruptcy action of Pennmount Industries, Inc. in the United States Bankruptcy Court for the Middle District of Pennsylvania to Case No. BK-79-678.

WHEREFORE, the defendant demands that the relief requested by the plaintiff in Count I of its Complaint be denied.

COUNT II**FIRST DEFENSE**

The defendant reasserts its answers to the allegations of the

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plaintiff contained in paragraphs 1-6 of Count I of the Complaint; and denies each and every other allegation contained in Count .I of the Complaint.

SECOND DEFENSE

The Complaint fails to state a claim against the defendant upon which relief can be granted. The plaintiff failed to provide the plaintiff with notice within sixty (60) days of the making of any assessment against Pennmount Industries, Inc. for nonpayment of federal withholding taxes and FICA taxes as required by 26 USC Section 6303.

THIRD DEFENSE

The plaintiff has waived its rights against the defendant by failing to diligently prosecute its claim against Pennmount Industries, Inc., the officers and directors of Pennmount Industries, Inc. and the defendant during the pendency of the bankruptcy action of Pennmount Industries, Inc. in the United States Bankruptcy Court for the Middle District of Pennsylvania to Case No. BK-79-678.

FOURTH DEFENSE

In the event that the defendant is found obligated to the plaintiff by virtue of the provisions of 26 USC Section 3505 (b) such liability would be computed by adding the total sum of the amount supplied by the defendant to Pennmount Industries, Inc. for the payment of wages plus interest and taking twenty-five (25%) percent of that figure as the statutory amount due the plaintiff.

Appendix E

WHEREFORE, the defendant demands that the relief requested by the plaintiff in Count II of its Complaint be denied.

By: s/ Martin A. Flayhart

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(717) 255-1155

APPENDIX F — RELEVANT STATUTES

26 U.S.C. Section 3505(a): Direct payment by third parties. For purposes of sections 3102, 3202, 3402, and 3403, if a lender, surety, or other person, who is not an employer under such sections with respect to an employee or group of employees, pays wages directly to such an employee or group of employees, employed by one or more employers, or to an agent on behalf of such employee or employees, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer.

26 U.S.C. Section 3505(b): Personal liability where funds are supplied. If a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required by this subtitle to be deducted and withheld by such employer from such wages, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer with respect to such wages. However, the liability of such lender, surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied to or for the account of such employer for such purpose.

Appendix F

26 U.S.C. Section 6303(a): General rule. Where it is not otherwise provided by this title, the Secretary shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address.

26 U.S.C. Section 6501(a): General rule. Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

26 U.S.C. Section 6502(a): Length of period. Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun—

(1) within 6 years after the assessment of the tax

Appendix F

40 U.S.C. Section 270(a)(d): Every performance bond required under this section shall specifically provide coverage for taxes imposed by the United States which are collected, deducted, or withheld from wages paid by the contractor in carrying out the contract with respect to which such bond is furnished. However, the United States shall give the surety or sureties on such bond written notice, with respect to any such unpaid taxes attributable to any period, within ninety days after the date when such contractor files a return for such period, except that no such notice shall be given more than one hundred and eighty days from the date when a return for the period was required to be filed under the Internal Revenue Code of 1954 [26 USC § 1 et seq.]. No suit on such bond for such taxes shall be commenced by the United States unless notice is given as provided in the preceding sentence, and no such suit shall be commenced after the expiration of one year after the day on which such notice is given.

No. 85-1736

2

Supreme Court, U.S.
FILED

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JOSEPH F. SPANIOLO, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1985

JERSEY SHORE STATE BANK, PETITIONER

v.

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE THIRD CIRCUIT*

BRIEF FOR THE UNITED STATES

CHARLES FRIED
Solicitor General

ROGER M. OLSEN
Acting Assistant Attorney General

WYNETTE J. HEWETT
BRUCE R. ELLISEN
Attorneys

*Department of Justice
Washington, D.C. 20530
(202) 635-2217*

QUESTION PRESENTED

Section 3505 of the Internal Revenue Code provides that, where a lender furnishes funds directly or indirectly to an employer for the payment of wages, the lender in certain circumstances may be personally liable if the required employment taxes are not withheld from those wages and paid over to the IRS. The question presented is whether, as a prerequisite to the government's maintenance of a civil suit to collect the lender's personal liability in such circumstances, the IRS must have sent to the lender, within 60 days of making an assessment of the unpaid taxes against the employer, a copy of the tax bill that is required to be sent to the employer under Section 6303(a).

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In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1736

JERSEY SHORE STATE BANK, PETITIONER

v.

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE THIRD CIRCUIT*

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-24a) is reported at 781 F.2d 974. The opinion of the district court (Pet. App. 27a-37a) is reported at 628 F. Supp. 15.

JURISDICTION

The judgment of the court of appeals was entered on January 10, 1986. A timely petition for rehearing was denied on February 4, 1986 (Pet. App. 25a-26a). The petition for a writ of certiorari was filed on April 22, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

On December 30, 1983, the United States brought this action in the United States District Court for the Middle District of Pennsylvania against petitioner, a bank with its

principal place of business in Jersey Shore, Pennsylvania (Pet. App. 27a-28a). The government's complaint alleged that petitioner, beginning in October 1977, had lent funds to Pennmount Industries, Inc., under circumstances that rendered petitioner personally liable, pursuant to Section 3505 of the Internal Revenue Code,¹ for a portion of Pennmount's unpaid withholding taxes (Pet. App. 2a, 38a-41a). In its answer, petitioner admitted making commercial loans to Pennmount, but denied any liability under Section 3505 (Pet. App. 3a, 46a-49a).

Petitioner moved for summary judgment, contending that the government was precluded from suing it because the government had not provided it with notice of the tax assessments against Pennmount within the 60-day period specified in Section 6303(a) of the Code. That Section provides that the Commissioner, as soon as practicable after making a tax assessment, and in any event within 60 days after making an assessment, must "give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof." Petitioner submitted that, if the instant suit were successful, it would be a "person liable for the unpaid tax" within the meaning of Section 6303(a). The bank accordingly argued that the Commissioner was required, within 60 days of making the assessments against Pennmount, to send the bank as well as Pennmount a copy of the tax bill described in Section 6303(a).

The district court granted petitioner's motion for summary judgment (Pet. App. 27a-36a). Relying on *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983), the district court held that the notice and demand for payment specified in Section 6303(a) must timely be sent, not only to the taxpayer against whom the

¹Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

taxes in question have been assessed, but also to third parties against whom the government might seek to establish a future liability in a civil suit under Section 3505 (Pet. App. 33a-35a). Since the government conceded that it had not notified petitioner of the assessments against Pennmount prior to the commencement of the instant suit on December 30, 1983 (*id.* at 32a), the district court held that the government's suit was barred (*id.* at 35a-36a).

The court of appeals reversed, one judge dissenting (Pet. App. 1a-24a). The court expressly declined to follow (*id.* at 7a-8a) the Seventh Circuit's decision in *Associates Commercial* and the Eleventh Circuit's subsequent decision in *United States v. Merchants National Bank*, 772 F.2d 1522 (11th Cir. 1985), petition for cert. pending, No. 85-1480. Rather, the court of appeals held that Section 6303(a) requires notice only to those persons against whom the taxes in question have been assessed, and that "the government's failure to provide [a lender] with a copy of the notice of assessment and demand for payment sent to [the employer] does not bar its suit to collect [the lender's] liability under section 3505" (Pet. App. 17a). The bank's petition for rehearing was denied (*id.* at 25a-26a).

ARGUMENT

As the court of appeals observed, this case presents the same question as that presented in *United States v. Merchants National Bank*, petition for cert. pending, No. 85-1480. That question is whether, as a prerequisite to the government's maintenance of a civil suit to collect a lender's personal liability under Section 3505 for unpaid withholding taxes, the government must have sent to the lender, within 60 days of making an assessment of such taxes against the employer, a copy of the tax bill that is required to be sent to the employer under Section 6303(a). The Third Circuit below decided this question in a way that conflicts

with the decisions of the Seventh Circuit in *Associates Commercial* and of the Eleventh Circuit in *Merchants National Bank*. In our petition for a writ of certiorari in the latter case, we showed that this conflict in the circuits involves an important question of federal tax law warranting this Court's review, and we explained why we believe that the Third Circuit in the instant case answered that question correctly.²

Since the question presented here and in *Merchants National Bank* is a pure question of statutory construction unaffected by the facts of the two cases, we see little merit in petitioner's suggestion (Pet. 12) that the Court should grant both petitions and direct that the cases be "joined for argument." We think that the instant case in fact presents a slightly better vehicle for resolving the question. The respondent in *Merchants National Bank* has filed a cross-petition for a writ of certiorari (No. 85-1633) that in essence urges a variety of alternative grounds for affirmance. Although we have demonstrated the insubstantiality of those arguments in our brief opposing the cross-petition (85-1633 Br. in Opp. at 4-9), the instant case, because it is unencumbered by such baggage, presents the Section 3505 question more cleanly. The Court may thus find it appropriate to grant certiorari in the instant case and hold our petition in *Merchants National Bank* pending disposition of this case. Alternatively, it would be appropriate to grant certiorari in *Merchants National Bank* and hold this case pending the outcome there.

²We are supplying petitioner's counsel with a copy of our petition in *Merchants National Bank*.

CONCLUSION

The petition for a writ of certiorari should be granted or, alternatively, should be held pending disposition in No. 85-1480.

Respectfully submitted.

CHARLES FRIED
Solicitor General

ROGER M. OLSEN
Acting Assistant Attorney General

WYNETTE J. HEWETT
BRUCE R. ELLISEN
Attorneys

MAY 1986

(2)
No. 85-1736

Supreme Court, U.S.

FILED

JUL 31 1986

JOSEPH E. SPANIOLO, JR.
CLERK

In The
Supreme Court of the United States
October Term, 1985

JERSEY SHORE STATE BANK,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States
Court of Appeals for the Third Circuit

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED APRIL 22, 1986
CERTIORARI GRANTED JUNE 2, 1986

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UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 85-5263

UNITED STATES OF AMERICA,

Appellant

v.

JERSEY SHORE STATE BANK,

Appellee

(D.C. Civil No. 83-1879)

RELEVANT DOCKET ENTRIES

DATE	FILINGS—PROCEEDINGS
1985	
April 12	Appeal of the plaintiff United States from the Order and Judgment entered March 20, 1985 by the District Court
Nov. 5	Oral argument before panel consisting of Seitz, Rosenn and Weis, Circuit Judges
1986	
Jan. 10	Opinion of panel per Seitz, C. J. reversing judgment of the District Court and remanding; Weis, C. J. dissenting
Jan. 10	Judgment against appellee Jersey Shore State Bank in favor of appellant United States reversing and remanding case to the District Court for further proceedings with costs taxed against appellee
Jan. 23	Petition for panel rehearing and rehearing in banc filed by appellee Jersey Shore State Bank

Feb. 4 Order of Court per Seitz, C. J. denying Petition
for rehearing by panel and rehearing in banc

March 7 Order of Court per Seitz, C. J. further staying
the issuance of the mandate to and including
April 25, 1986 to allow for filing of Petition for
Writ of Certiorari to the United States Su-
preme Court

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

Civil No. 83-1879

UNITED STATES OF AMERICA,
Plaintiff

v.

JERSEY SHORE STATE BANK,
Defendant

RELEVANT DOCKET ENTRIES

DATE	PROCEEDINGS
1983	
Dec. 30	Complaint filed by plaintiff United States against defendant Jersey Shore State Bank
1984	
Feb. 17	Answer to complaint filed by Jersey Shore State Bank
Oct. 30	Motion for Summary Judgment filed by plain- tiff United States
Oct. 30	Affidavit of John T. Repsher, Internal Revenue Agent filed by plaintiff United States
Oct. 31	Motion for Summary Judgment filed by de- fendant Jersey Shore State Bank with annexed Statement of Material Facts as to which the de- fendant contends there is no genuine issue to be tried
1985	
March 20	Order of United States District Court denying Motion for Summary Judgment of plaintiff United States, granting Motion for Summary

Judgment of defendant Jersey Shore State Bank and directing Clerk to enter judgment in favor of defendant Jersey Shore State Bank and to close file

March 20 Judgment of United States District Court entered by Clerk in favor of defendant Jersey Shore State Bank

IN THE UNITED STATES DISTRICT COURT FOR
THE MIDDLE DISTRICT OF PENNSYLVANIA

Civil Action No. 83-1879

UNITED STATES OF AMERICA

Plaintiff,

v.

JERSEY SHORE STATE BANK,

Defendant.

AFFIDAVIT OF JOHN T. REPSHER

JOHN T. REPSHER, being first duly sworn, states as follows:

1. I am a duly commissioned Internal Revenue Officer, employed by the District Director of Internal Revenue, Pittsburgh District, with my post of duty at Altoona, Pennsylvania.

2. One of my duties as an Internal Revenue Officer is to collect taxes which have been assessed against taxpayers, and to determine what sources, if any, are available for the collection of unpaid tax liabilities.

3. I have been assigned to collect the assessed but unpaid employment tax liabilities for the quarters ended December 31, 1977, March 31, 1978, June 30, 1978, September 30, 1978, December 31, 1978, March 31, 1979, June 30, 1979, September 30, 1979, December 31, 1979, December 31, 1979, and March 31, 1980, of Pennmount Industries, Inc. (Pennmount), Lock Haven, Pennsylvania 17745.

4. During the fourth quarter of 1977 through the first quarter of 1980, Pennmount failed to pay over to the United States of America federal income, and Federal Insurance Contribution Act ("FICA") taxes required to be withheld from the wages of Pennmount employees.

5. A delegate of the Secretary of the Treasury made assessments against Pennmount and gave notice and demand according to law for federal income taxes and FICA taxes required to be withheld and deducted from the wages of Pennmount employees for the quarters described in paragraph 3, above, as well as quarters not at issue in this lawsuit.

6. Attached hereto as Exhibit A is a true and accurate summary of the unpaid assessed liabilities of Pennmount, for employment taxes (withholding taxes and employee's share of FICA taxes), which Pennmount was required to withhold from the wages of its employees, for the calendar quarters listed in paragraph 3, above. Exhibit A lists withheld income tax, withheld FICA tax, and interest through June 30, 1981. Interest continues to run on the unpaid balance at the rate prescribed in Section 6621 of the Internal Revenue Code of 1954, compounded daily, from the date the payment was due, until the date the tax is paid.

7. No part of the taxes and interest listed in Exhibit A has been paid.

8. Jersey Shore State Bank has not paid any of the withholding taxes assessed against Pennmount for the quarters listed in paragraph 3 above.

/s/ John T. Repsher
Internal Revenue Officer
Internal Revenue Service
Altoona, Pennsylvania

Subscribed and sworn to before me this 25th day of October, 1984.

/s/ Denise L. Mishock
Notary Public

My commission expires: January 26, 1987.

EXHIBIT A—AFFIDAVIT OF JOHN T. REPSHER

Quarter Ended	FICA (Employee's Share)	Withholding Tax	Interest (Through 6/30/81)	Total
Dec. 31, 1977	\$ 1,840.49	\$ 2,926.20	\$ 1,380.32	\$ 6,147.01
Mar. 31, 1978	5,899.84	8,503.70	3,954.86	18,358.40
June 30, 1978	4,030.17	6,457.20	2,722.36	13,209.73
Sep. 30, 1978	3,265.51	5,763.40	2,208.25	11,237.16
Dec. 31, 1978	3,345.09	6,889.10	2,349.51	12,583.70
Mar. 31, 1979	1,431.74	2,505.20	844.77	4,781.71
June 30, 1979	691.57	1,348.50	407.14	2,447.21
Sep. 30, 1979	809.43	1,459.07	418.51	2,687.01
Dec. 31, 1979	650.96	1,217.20	426.53	2,294.69
Mar. 31, 1980	872.74	1,584.30	343.91	2,800.95
TOTAL	\$22,837.54	\$38,653.87	\$15,056.16	\$76,547.57

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

CIVIL NO. 83-1879
Complaint Filed 12/30/83
(Judge Muir)

UNITED STATES OF AMERICA,

Plaintiff

vs.

JERSEY SHORE STATE BANK,

Defendant

MOTION FOR SUMMARY JUDGMENT

The defendant, Jersey Shore State Bank, by its counsel, Martin A. Flayhart, Esquire, moves the Court as follows:

1. That the Court enter, pursuant to Fed. R. Civ. P. 56, summary judgment in favor of the defendant, Jersey Shore State Bank, and against the plaintiff, United States of America, on Counts I and II of the plaintiff's Complaint on the ground that there is no genuine issue as to any material fact as set forth below and that the defendant is entitled to judgment as a matter of law.

2. This Motion is based upon the following:

(a) Those uncontroverted allegations in the plaintiff's Complaint which are admitted in the defendant's Answer.

(b) The answers of the plaintiff to Interrogatories 1B, 1C, and 2 of the defendant's First Set of Interrogatories. These responses indicate that no notice was given by the plaintiff to the defendant within sixty

(60) days of the date of the notice of filing or assessment by the plaintiff against Pennmount Industries, Inc. for any lien assessments which had been filed by the plaintiff against Pennmount Industries, Inc. Copies of the plaintiff's answers to the defendant's First Set of Interrogatories are attached hereto as defendant's Exhibit 1 and made a part of this Motion.

(c) The affidavit of Theodore H. Reich, President of Jersey Shore State Bank, attached hereto as defendant's Exhibit 2 indicating that no notice was given by the plaintiff to the defendant within sixty (60) days of the date of the notice of filing or assessment by the plaintiff against Pennmount Industries, Inc. for any lien assessments which have been filed by the plaintiff against Pennmount Industries, Inc.

3. The failure of the plaintiff to provide the defendant with the required notice of filing or assessment of lien assessments against Pennmount Industries, Inc. was in contravention of the statutory duty placed upon the plaintiff pursuant to 26 USC Section 6303(a), thereby entitling the defendant to summary judgment against the plaintiff.

WHEREFORE, the defendant requests the Court to enter summary judgment in favor of the defendant and against the plaintiff on Count I and Count II of the plaintiff's complaint.

/s/ By: Martin A. Flayhart
Attorney for Defendant
P.O. Box 526
128 South Main Street
Jersey Shore, PA 17740
(717) 398-4510

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

CIVIL NO. 83-1879
Complaint Filed 12/30/83
(Judge Muir)

UNITED STATES OF AMERICA,
Plaintiff
vs.

JERSEY SHORE STATE BANK,
Defendant

*STATEMENT OF MATERIAL FACTS AS TO
WHICH THE DEFENDANT CONTENDS
THERE IS NO GENUINE ISSUE TO BE TRIED*

Pursuant to Rule 401.4 of the Rules of Court for the United States District Court for the Middle District of Pennsylvania, the defendant, Jersey Shore State Bank, submits the following statement of material facts in support of its Motion for Summary Judgment as to which the defendant contends there is no genuine issue to be tried:

1. The defendant is a bank which provided money as a commercial loan to Pennmount Industries, Inc., a corporation engaged in the manufacture of wooden tables and chairs.

2. No notice was given by the plaintiff to the defendant within sixty (60) days of the date of the notice of filing or assessment by the plaintiff against Pennmount Indus-

tries, Inc. for any lien assessments which had been filed by the plaintiff against Pennmount Industries, Inc.

/s/ Martin A. Flayhart
Attorney for Defendant
P.O. Box 526
128 South Main Street
Jersey Shore, PA 17740
(717) 398-4510

UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

CIVIL NO. 83-1879
Complaint Filed 12/30/83
(Judge Muir)

UNITED STATES OF AMERICA,
Plaintiff
vs.

JERSEY SHORE STATE BANK,
Defendant

AFFIDAVIT OF JAMES P. STOPPER,
CERTIFIED PUBLIC ACCOUNTANT

COMMONWEALTH OF PENNSYLVANIA :
COUNTY OF LYCOMING : SS:
:

James P. Stopper, being duly sworn according to law,
deposes and says as follows:

1. The affiant is a certified public accountant and member of the firm of Rogers, Huber and Associates, with offices at 454 Pine Street, Williamsport, Pennsylvania.

2. The affiant has examined the records for the period of October 1, 1977 through March 31, 1979, of the regular checking account of Pennmount Industries, Inc., Account No. 147-850 maintained with Jersey Shore State Bank.

3. The affiant further states that he has examined the records for the period of October 26, 1978 through March 31, 1980, of the special checking account of Pennmount Industries, Inc., Account No. 166-308 maintained with Jersey Shore State Bank.

4. Based upon the examinations of the regular checking Account No. 147-850 of Pennmount Industries, Inc. the affiant states that for the period of October 1977 through November 1978 that deposits into the account by Pennmount Industries, Inc. from sources other than loans by Jersey Shore State Bank, with the exception of May 1978, were in excess of the net payroll paid by Pennmount Industries, Inc. to its employees.

5. The affiant further states that the total deposits by Pennmount Industries, Inc. into the regular checking Account No. 147-850 for the period from October 1, 1977 through the end of November 1978, from sources other than bank loans from Jersey Shore State Bank was in a total amount of \$409,867.66, as opposed to the net payroll for the same period for employees of Pennmount Industries, Inc. of \$265,230.91, see attached Exhibit A.

6. The affiant states that with regard to the special Account No. 166-308 of Pennmount Industries, Inc. with Jersey Shore State Bank, that for the period from October 26, 1978 through January 1979, that the total deposits by Pennmount Industries, Inc. from sources other than loans from Jersey Shore State Bank was in excess of the net payroll paid by Pennmount Industries, Inc. to its employees. The deposits from sources other than bank loans was in the amount of \$100,427.94, as opposed to a total net payroll for Pennmount employees of \$43,031.63. See attached Exhibit B.

7. The affiant has attached hereto as Exhibit A, a summary of the deposits made by Pennmount Industries, Inc. from sources other than bank loans for the period of October 1, 1977 through November 1978, along with the corre-

sponding amounts paid for net payroll by Pennmount Industries, Inc. to its employees for the corresponding period.

8. The affiant has attached hereto as Exhibit B a summary of the special account No. 160-308 of Pennmount Industries, Inc. with Jersey Shore State Bank showing the amounts deposited from October 26, 1980 through January 1979, by Pennmount Industries, Inc. apart from any loans from Jersey Shore State Bank along with the corresponding net payroll paid by Pennmount Industries, Inc. to its employees.

IN WITNESS WHEREOF, James P. Stopper has hereunto set his hand and seal certifying to the truth and correctness of the above statements.

/s/ James P. Stopper

Sworn to and subscribed before me
this 9th day of November, 1984.

Notary Public
(Notary Stamp)

Exhibit A

Regular Account No. 147-850

Month	Deposits by Pennmount from Sources Other than Loans from Jersey Shore State Bank	Payroll Check
October, 1977	\$42,883.99	\$26,008.03
November, 1977	51,477.60	26,146.39
December, 1977	32,414.54	27,409.03
January, 1978	62,662.60	26,076.01
February, 1978	26,485.35	21,329.31
March, 1978	33,524.61	32,156.25

April, 1978	16,042.93	12,564.39
May, 1978	23,417.48	32,490.36
June, 1978	15,354.48	9,648.91
July, 1978	25,454.50	10,795.11
August, 1978	24,385.24	12,544.65
September, 1978	19,537.46	14,880.54
October, 1978	33,369.92	13,181.93
November, 1978	2,856.96	
Total:	\$409,867.66	\$265,230.91

Exhibit B

Special Account No. 166-308

Month	Deposits by Pennmount from Sources Other than Loans from Jersey Shore State Bank	Payroll Check
October—		
November, 1978	\$54,709.03	\$21,802.78
December, 1978	31,162.42	16,425.41
January, 1979	14,556.49	4,803.44
Total:	\$100,427.94	\$43,031.63

(Filed as an attachment to the Brief of Defendant Opposing the Plaintiff's Motion for Summary Judgment. The aforesaid brief and remaining exhibits have been omitted in printing.)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 85-5263

UNITED STATES OF AMERICA, Appellant

vs.

JERSEY SHORE STATE BANK, Appellee
(D. C. Civil No. 83-1879)

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE MIDDLE
DISTRICT OF PENNSYLVANIA

Present: SEITZ, WEIS, and ROSENN, *Circuit Judges*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Middle District of Pennsylvania and was argued by counsel November 5, 1985.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, entered March 20, 1985, be, and the same is hereby reversed and the cause remanded to the said District Court for further proceedings consistent with the opinion of this Court. Costs taxed against the appellee.

ATTEST:

/s/ Sally Mrvos
Clerk

January 10, 1986

No. 85-1736

Supreme Court, U.S.

FILED

JUL 31 1986

JOSEPH F. SPANIOL, JR.
CLERK

In The
Supreme Court of the United States
October Term, 1985

—○—
JERSEY SHORE STATE BANK,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

—○—
**ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE THIRD CIRCUIT**

—○—
BRIEF FOR PETITIONER

—○—
MARTIN A. FLAYHART
CARPENTER, HARRIS & FLAYHART
128 South Main Street
Jersey Shore, Pennsylvania
(717) 398-4510
Counsel for Petitioner

QUESTION PRESENTED

Whether the Third Circuit Court of Appeals was correct in holding that the Internal Revenue Service does not need to give a third party lender notice pursuant to Section 6303(a) of the Internal Revenue Code of an assessment against an employer for unpaid employee income withholding taxes and Federal Insurance Contribution Act ("FICA") taxes in order for the Internal Revenue Service to obtain judgment against such third party lender for the employer's liability for these taxes under Sections 3505(a) and 3505(b) of the Internal Revenue Code.

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The opinion of the court of appeals is reported at 781 F. 2d 974 (Pet. App. 1a-24a). The opinion of the district court is reported at 628 F. Supp. 15 (Pet. App. 27a-37a).

 JURISDICTION

The judgment of the court of appeals was entered on January 10, 1986. (J.A. 16). A timely petition for rehearing and rehearing in banc was denied on February 4, 1986. (Pet. App. 25a-26a). The petition for a writ of certiorari was filed on April 22, 1986 and granted on June 2, 1986. This Court has jurisdiction to review the judgment of the court of appeals by writ of certiorari pursuant to 28 U.S.C. § 1254(1).

 STATUTES INVOLVED

Sections 3505 and 6303(a) of the Internal Revenue Code of 1954 (26 U.S.C.) (Pet. App. 50a-52a).

STATEMENT OF THE CASE

The petitioner Jersey Shore State Bank, (hereinafter referred to as "Jersey Shore" or "the Bank") is an authorized Pennsylvania banking institution with its main office at 115 South Main Street, Jersey Shore, Pennsylvania.¹ (Pet. App. 38a-39a). Pennmount Industries, Inc., (hereinafter referred to as "Pennmount") was a corporation located in Lock Haven, Pennsylvania, engaged in the manufacture of wooden tables and chairs. (Pet. App. 28a). In February of 1976 the Bank began to make commercial loans to Pennmount in the normal course of business. The first loan was for \$20,000.00 for working capital. Subsequently, additional loans totalling \$270,000.00 were made to Pennmount by Jersey Shore, secured by mortgages on Pennmount property and by specific receivables of Pennmount. (Pet. App. 28a, 46a-47a).

Beginning with the fourth quarter of 1977 and continuing through the first quarter of 1980, Pennmount failed to pay over to the United States federal employee withholding income taxes and FICA taxes which it withheld from the wages of its employees. These taxes are not in dispute. (Pet. App. 28a).

On December 30, 1983, the United States filed suit against Jersey Shore in the United States District Court for the Middle District of Pennsylvania in order to collect all employee withholding taxes and FICA taxes which Pennmount had failed to pay for the fourth quarter of

¹Jersey Shore State Bank is a wholly owned subsidiary of Penns Woods Bancorp, Inc. Affiliate: Woods Real Estate Development Company, Inc.

1977 through the first quarter of 1980, plus accrued penalties and interest. The Government sought to impose liability on the Bank as a third party lender pursuant to Section 3505 of the Internal Revenue Code of 1954.² (Pet. App. 38a-45a, J.A. 5-7).

Count I of the complaint alleged that the Bank had paid wages directly to Pennmount's employees and was accordingly liable under Section 3505(a) for the full amount of the unpaid employment taxes of \$76,547.57 plus interest. Count II of the complaint alleged that the Bank supplied funds to Pennmount for the purpose of paying wages, knowing that Pennmount did not intend or would be unable to pay withholding taxes. Accordingly, Count II alleged that the Bank was liable under Section 3505(b) for the unpaid employment taxes in an amount not exceeding 25% of the amount lent; in this case, \$72,069.00 (Pet. App. 38a-45a).

Jersey Shore filed an Answer admitting that it had provided money to Pennmount as commercial loans and raised as a defense, *inter alia*, to both Counts I and II of the Government's complaint the failure of the Government to provide it with notice within sixty days of the making of any assessment against Pennmount for non-payment of federal withholding taxes and FICA taxes as required by Section 6303(a). (Pet. App. 46a-49a).

The Government moved for summary judgment against the Bank on Count I relating to the liability of

²Statutory references are to sections of the Internal Revenue Code of 1954 (26 U.S.C.) as amended, and as applicable to the time periods involved in this case, unless otherwise indicated.

the Bank under Section 3505(a). The Bank cross moved for summary judgment on Counts I and II relying on the failure of the United States to give notice to the Bank of the assessments against Pennmount as required by Section 6303(a). The United States admitted that the Bank had not been given notice with respect to the assessments against Pennmount which the Government sought to collect from the Bank and asserted that no such notice was required. (Pet. App. 3a).

The district court on March 20, 1985, entered judgment in favor of Jersey Shore on its motion for summary judgment following the rationale of the Seventh Circuit Court of Appeals in *United States v. Associates Commercial Corp.*, 721 F. 2d 1094 (7th Cir. 1983) (Pet. App. 33a-38a).

The Government filed an appeal from the decision of the district court in favor of the Bank with the United States Court of Appeals for the Third Circuit on April 12, 1985. (J.A. 1).

The Third Circuit by a 2-1 panel majority reversed the decision of the district court on January 10, 1986, with a dissenting opinion filed by Judge Weis (Pet. App. 1a-24a).

Jersey Shore filed a timely petition for rehearing which was denied on February 4, 1986. (Pet. App. 25a). Subsequently, Jersey Shore filed a petition for writ of certiorari with this Court on April 22, 1986, which was granted June 2, 1986.

SUMMARY OF ARGUMENT

Section 6303(a) of the Internal Revenue Code requires that notice of a tax assessment be given to "each person liable for the unpaid tax." Jersey Shore is a person whom the Government seeks to hold liable for unpaid taxes owed by Pennmount. Jersey Shore was therefore entitled to receive notice of a tax assessment against Pennmount within sixty days of the assessment having been made as required by the plain language of Section 6303(a).

Section 3505 of the Code imposing derivative third party tax liability on lenders was enacted in 1966, twelve years after Section 6303(a) became part of the Code. Congress did not change the language of Section 6303(a) when it enacted Section 3505 to provide that notice should be given only to those persons against whom a tax had been assessed. There is no legislative history which can be cited to show that Congress in enacting Section 3505 intended to exempt the Government from the statutory notice requirements of Section 6303(a).

The failure of the Government to provide notice of a tax assessment to a third party lender results in a fundamental unfairness in the treatment afforded a person primarily liable for the tax and a lender who is secondarily liable. While an employer receives notice of a tax assessment within sixty days of it being made, the first notice a lender receives occurs when the Government files suit against it, which can be nine years after the tax is due. In the interim period lending personnel can change and records can be lost which would enable the lender to defend itself adequately against Section 3505 liability.

The Government seeks to have the advantage of an extended six year statute of limitations under Section 6502 of the Code against a third party lender and should likewise shoulder the burden of providing notice to the lender of the tax assessment as required by the express language of Section 6303(a).

In requiring the Internal Revenue Service to give notice, there is no undue administrative burden in determining the lenders who should receive the notice. The Internal Revenue Service has three years to make an assessment before the sixty day period for giving notice begins to run. During this period the IRS may use its extraordinary investigative powers to determine the parties who should be given notice. If the Internal Revenue Service determines that it is unable to comply with the existing notice requirement, it should petition Congress to change the statute and not ask the Court to make a strained interpretation of the plain meaning of the statutory language.

The Third Circuit misconstrued the legislative history of the enactment of Section 3505 in citing sections of the House and Senate reports which refer to the amendment to Section 1 of the Miller Act, 40 U.S.C. § 270a(d), requiring contractors to provide bonds on public work contracts to guarantee payment of employer withholding and FICA taxes. Congress had a clear concern in amending the Miller Act, *supra*, that third party sureties receive notice of unpaid employer taxes before liability could be imposed on them. Such notice is also required to be given third party lenders under Section 6303(a) of the Code which remained unchanged after the enactment of Section 3505 and requires that "each person liable for the unpaid tax" should receive notice of the tax assessment.

ARGUMENT

I. SECTION 6303(a) OF THE CODE REQUIRES THAT NOTICE OF A TAX ASSESSMENT BE GIVEN TO A THIRD PARTY LENDER.

A. The statutory language of Section 6303(a) and the legislative history of Section 3505 require that notice of a tax assessment be given to a third party lender.

Section 6303(a) of the Code is clear in its requirement that once the United States has made a tax assessment that notice of that assessment must be given within sixty days "to each person liable for the unpaid tax." (Pet. App. 51a). As noted by Judge Weis in his dissent in the present case:

"The reference to 'each person liable' in § 6303 is not in the least ambiguous. In the case at hand, the government contends that defendant is liable for the tax. Therefore, it seems inescapable that defendant should have been given notice.

"The IRS wishes us to redraft that section so that it requires notice only to those individuals against whom taxes have been assessed. The reasons offered for this revision have some logic and would possibly ease administrative burdens on the government, but the arguments are directed to the wrong forum. They should be presented to Congress, not the courts." (22a).

In the present case, the Bank made commercial loans to Pennmount in the normal course of business. More than five years after Pennmount had begun to fail to make payment of federal employment and FICA taxes due to the United States, the Government filed the present suit against the Bank for third party derivative tax liability

pursuant to Sections 3505(a) and 3505(b) of the Code. At no time did the United States provide notice to the Bank of any assessment which it had made for the unpaid taxes against Pennmount as required under Section 6303(a) of the Code (Pet. App. 31a, 47a).

Section 3505 of the Code was enacted by Congress in order to correct the situation which existed where:

"Under present law, only 'employers' are liable for income, social security, and railroad retirement taxes required to be withheld and deducted from wages. There are cases, however, where persons other than the employers directly, or indirectly pay the wages. Where this occurs, problems have arisen because, in some instances, these other persons have paid employees only the 'net' wages and have not paid, either to the employees or to the Government, the withholding taxes due the Government." H. R. Rep. No. 1884, 89th Cong., 2d Sess. at 20; S. Rep. No. 1708, 89th Cong., 2d Sess. at 21.

Nowhere, however, in the legislative history, is there any indication that Congress intended to enact Section 3505 in a vacuum, free of any requirements that exist under the Code for the imposition of liability on a third party lender.

As noted by this Court in the case of *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102 (1980), the beginning point of interpreting any statute is the language of the statute itself. Justice Rehnquist writing for the Court stated: "We begin with the familiar cannon of statutory construction that the starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to

the contrary, that language must ordinarily be regarded as conclusive." 447 U.S. at 108.

The comments of Rep. Byrnes on the floor of the House of Representatives speaking in support of the Federal Tax Lien Act of 1966, Pub. L. 89-719, 80 STAT. 1125, indicated that:

"In addition to the changes relating to the priority of the Federal tax lien, the bill makes many other changes in the rules governing the seizure of property for the collection of tax, the release of liens, and other matters generally related to the collection by the Government of delinquent tax liabilities. The changes are intended to make collection procedures more equitable and more convenient to taxpayers, the Government, and the general public." 112 Cong. Rec. at 22227.

There is no record in the House or Senate reports or the floor debates in Congress that Section 3505 was intended to be placed into the Internal Revenue Code without being subject to the notice provisions of Section 6303(a). It is submitted that Congress must be presumed to have been aware of the statutory provisions of the Internal Revenue Code when it enacted the amendments to the same in the Federal Tax Lien Act of 1966, *supra*. The language of Section 6303(a) remained unchanged after Section 3505 was enacted into the Code. Absent any legislative history to the contrary in the enactment of Section 3505, the plain meaning of Section 6303(a) requires that the Government give notice of a tax assessment to a third party lender within sixty days of such assessment.

As noted by Judge Weis in the instant case in his dissent in the Third Circuit:

"In this case, I cannot even say with assurance that the addition to the statute that the IRS proposes was inadvertently omitted. Certainly, the legislative

history of § 6303 provides no basis for such a belief. Moreover, the legislative history of § 3505 does not suggest that notice should not be provided lenders who may be secondarily liable. 'Congressional silence no matter how "clanging" cannot override the words of the statute.' *Sedima v. Imrex Co., Inc.*, 53 U.S.L.W. 5034, 5038 n. 13 (June 25, 1985)." (Pet. App. 22a-23a).

If Congress had intended that the provision of Section 6303(a) relative to the sixty days notice of an assessment were not to apply to persons whom the Government seeks to hold liable under Section 3505, an exception would have been placed in the statute to indicate this fact. Such an exception is not, however, present.

B. The Seventh Circuit has decided that notice of a tax assessment must be given to a third party lender.

The Seventh Circuit Court of Appeals in *United States v. Associates Commercial Corp.*, *supra*, decided that Section 6303(a) mandates notice by the Government to third party lenders upon whom the Government seeks to impose derivative tax liability under Section 3505.

In *Associates*, *supra* the Government made an assessment against the employer, Dot Engravers, Inc., for unpaid employee withholding taxes. Associates, as lender, had previously made commercial loans to the employer. No notice of the filing of the assessments against the employer was given to the lender. Subsequently, six years and three months after the first assessment was made, the Government sued the lender for the unpaid taxes of the employer alleging liability pursuant to Section 3505(b) of the Code. The Seventh Circuit stated: "We hold that Section 6303(a) mandates notice to a lender subject to

Section 3505(b) liability and that this civil proceeding is barred because of the absence of such statutorily required notice." 721 F. 2d at 1098.

The Court in *Associates*, *supra*, reviewed the previous decisions that the Government had relied upon in two District Court opinions, *United States v. Marine Midland Bank*, 544 F. Supp. 268 (W.D.N.Y. 1982) and *United States v. First National Bank of Carbondale*, 499 F. Supp. 51 (M.D.Pa. 1980). The Court in *Associates*, *supra*, found that such reliance by the Government was misplaced. The Court noted that:

"In both cases the district courts based their opinions on the absence of a notice requirement in the Treasury Regulations promulgated under Section 3505 rather than looking to Section 6303(a) itself. 544 F. Supp. at 271; 499 F. Supp. at 53. Furthermore the silence of Section 3505(b) and the regulations thereunder does not create an inference as to whether Section 6303(a) requires notice since, as Judge Will noted, Section 3505(b) itself merely identifies the circumstances under which a lender's liability arises. The procedures for enforcing Section 3505(b) and other tax provisions are contained in Subtitle F of the Internal Revenue Code, of which Section 6303(a) is one provision. 548 F. Supp. at 175, n. 1. On the other hand, Section 3505(b) is part of Subtitle C dealing with employment taxes." 721 F. 2d at 1099.

C. The analysis of Section 6303(a) by the Third Circuit in the instant case failed to consider the effect of the enactment of Section 3505.

In the instant case the Third Circuit reviewed the administrative changes made by the President's reorganization plans with regard to modifying the 1939 Internal Revenue Code to abolish the office of Collector of Internal

Revenue, thereby combining the function of the tax collector as part of the duties of the Secretary of the Treasury. The Third Circuit indicated that Congress enacted Section 6303(a) into the Code in 1954, incorporating the administrative changes previously adopted by the President's Reorganization Plan of 1950, Reorg. Plan No. 26 of 1950, 15 Fed. Reg. 4935 (1950), *reprinted* in 5 U.S.C.A. app. at 274-75 (West 1967) and the Reorganization Plan of 1952, Reorg. Plan No. 1 of 1952, 17 Fed. Reg. 2243, *reprinted* in 5 U.S.C.A. app. at 280-81 (West 1967). (Pet. App. 14a-17a).

The Third Circuit held that there had been no change in the law by Congress between the Internal Revenue Code of 1939 and the 1954 Code when Congress enacted Section 6303(a) in the 1954 Code. (Pet. App. 17a). The Court noted:

"Under these circumstances, we find that Congress did not intend to change the law with respect to who must receive notice when it enacted section 6303(a). Congress was fully aware of the changes brought by Reorg. Plan No. 26 and Reorg. Plan No. 1 when it enacted the 1954 code. It only follows that the Congress would adapt the language of the code to fit the existing organization of the Department of the Treasury and the Internal Revenue Service. Thus, absent any legislative history to the contrary, we find that section 6303(a), like its predecessor statute under the 1939 Code, only requires notice to those individuals against whom the government can proceed administratively." (Pet. App. at 17a).

The difficulty with this analysis, however, is it ignores the fact that Section 3505 of the Code was enacted not as part of the 1954 revision but 12 years later in 1966. Congress may be presumed to have been aware of the ex-

press language of Section 6303(a) of the Code when it enacted the amendments under the Federal Tax Lien Act of 1966, *supra*, which included the new Section 3505 imposing derivative liability on third party taxpayers.

In enacting Section 3505 Congress created an additional group of persons who would be liable for taxes. Absent any legislative history with regard to Section 3505 indicating that a lender, as a person liable for the unpaid tax of the employer, should not also receive notice of the assessment, Section 6303(a) clearly requires such notice of assessment to be given. There is nothing in the opinion of the Third Circuit nor, anything in the legislative history of the enactment of Section 3505 which establishes that this section was enacted by Congress without being subject to the plain language of Section 6303(a) requiring notice of assessment "to each person liable for the unpaid tax." Clearly, a third party lender whom the Government seeks to hold liable for an employer's taxes is one such person.

The Third Circuit also cited the holdings in *United States v. Erie Forge Company*, 191 F. 2d 627 (3rd Cir. 1951), *cert. denied*, 343 U.S. 930 (1952) and *Jenkins v. Smith*, 99 F. 2d 827 (2d Cir. 1938) (*per curiam*) accepting the Government's contention that it may bring suit for taxes where it has not assessed those taxes. (Pet. App. 11a-17a).

Jenkins, supra, and *Erie Forge, supra*, both dealt with pre-1954 Sections of the Internal Revenue Code in which the tax collector and not the Secretary of the Treasury,

was required to give notice within the ten days after assessment to each person liable for the taxes.³

Under the provisions of the Internal Revenue Code applicable in both *Jenkins, supra*, and *Erie Forge, supra*, the tax collector was authorized to collect taxes only by administrative remedies. He was not statutorily authorized to institute legal proceedings nor was there a statutory claim for derivative tax liability against third persons as exists under Section 3505.

After *Jenkins, supra*, and *Erie Forge, supra*, were decided, the Internal Revenue Code of 1954, Title 26, Subtitle F, legislatively merged the functions of collection and initiation of legal proceedings into one office of the Secretary of the Treasury. It is the Secretary of the Treasury who assesses taxes now pursuant to Section 6201, pursues administrative remedies under Section 6331 and authorizes the initiation of civil proceedings for tax collection under Section 7401, all of the aforesaid being contained within Subtitle F.

Section 3505 of the Code was not enacted, however, until 1966 pursuant to the Federal Tax Lien Act of 1966, *supra*. With the enactment of Section 3505, Congress did not exempt the Secretary of the Treasury from the notice provisions required under Section 6303(a).

In *Associates, supra*, the Seventh Circuit decided that since the same person, *i.e.* the Secretary of the Treasury, now controls the post-assessment administrative and liti-

³26 U.S.C. Section 1545 in *Jenkins, supra*, and 26 U.S.C. Section 3655 of the Internal Revenue Code of 1939 in *Erie Forge, supra*.

gation collection procedures under Subtitle F, that the general Section 6303(a) notice rule of Subtitle F applies equally to the Secretary, whether instituting administrative collection proceedings or legal collection proceedings. The Seventh Circuit interpreted both *Jenkins, supra*, and *Erie Forge, supra*, to hold that the person who fails to give the required notice to the taxpayer is barred from exercising all of the remedies to which he is statutorily empowered. Since the Secretary of the Treasury is now empowered to proceed with collection by litigation as well as by administrative remedy, both *Jenkins* and *Erie Forge* support the holding of the Seventh Circuit in *Associates*. See: *Associates, supra*, at 1100.⁴

⁴The argument of the Government before the Third Circuit that the Secretary of the Treasury is not authorized to proceed with litigation to collect the tax because the Justice Department is the litigating arm of the Government ignores basic agency law concepts. The Justice Department only institutes litigation at the request of the Secretary under Section 7401.

For the statutory history with regard to the distinction between the functions of the tax collector and the tax commissioner and the Department of Justice see the following: Act of July 1, 1862, ch. 119, 12 Stat. 432, 444, Section 31; Act of June 30, 1864, ch. 173, 13 Stat. 223, 239, Section 41; Act of July 13, 1866, ch. 184, 14 Stat. 93, 111, Section 9; Act of June 22, 1870, 16 Stat. 162, Sections 3, 5 and 16; Revised Statutes of 1878, Sections 3182, 3184, 3213 and 3214; Revenue Act of 1926, ch. 27, 44 Stat. 9, Section 280 (a); Internal Revenue Code of 1939, Sections 3654, 3655 and 3740 and Internal Revenue Code of 1954, 26 U.S.C. Sections 6501, 7401.

II. THE FAILURE OF THE GOVERNMENT TO PROVIDE NOTICE OF A TAX ASSESSMENT PLACES THE LENDER AT A FUNDAMENTAL DISADVANTAGE.

A. Additional procedural benefits are conferred upon the Government against a third party lender by the filing of a tax assessment against an employer.

The majority opinion of the Third Circuit is the present case failed to take account of the fact that the filing of the tax assessment confers additional procedural benefits upon the Government. Under Section 6501 of the Code, once the IRS has made an assessment against an employer within three years from the time that the tax liability arises, then it has the benefit of an additional six year period in order to file suit against either the employer or a third party lender. (Pet. App. 50a-51a). The Government, having the advantage of an additional six years in which to bring suit against a third party lender, refuses responsibility for giving such a taxpayer notice of the tax assessment as required by Section 6303(a). Such notice would allow the third party lender to evaluate its ongoing relationship with the employer-borrower, knowing that the Government intends to hold the lender liable for the taxes.

Both the lender and the employer are similarly situated in that both are taxpayers as defined in Section 7701(a)(14) of the Code, who are being held liable for the same taxes, *i.e.* unpaid FICA and employer withholding taxes. *See*: Westin, Richard A., *Lexicon of Tax Terminology* at 772 (New York, 1984).

Under Section 6303(a) the lender and the employer are also both persons "liable for the unpaid tax." How-

ever, the lender, under the Government's interpretation of the statute, which was adopted by the Third Circuit in the instant case, is not entitled to notice of the tax assessment, while the employer is. Such a distinction which is contrary to the plain language of Section 6303(a) creates a fundamental unfairness between the treatment afforded by the Government to an employer and that given a third party lender.

The employer has the advantage of receiving notice within sixty days of the assessment and the lender does not. As noted by Judge Weis in his dissent in the Third Circuit:

"The net effect of the Code revision urged by the IRS is to give less procedural protection to one secondarily liable than to the primary obligor. The notice of assessment will alert the taxpayer directly liable to the lengthened statute of limitations. He may then preserve pertinent records, arrange for payment, compromise, or take other steps in his own best interests. Without notice of the assessment, however, the party under § 3505 may not be alerted to his continuing exposure and concomitant risk. I am not convinced that Congress intended such an anomalous result." (Pet. App. 23a).

Having rejected the requirement of notice to a third party lender under Section 6303(a), the Government then turns around and relies upon Section 6502(a) to extend the statute of limitations against the lender for another six years without having provided any previous notice as required by Section 6303(a).

It is submitted that such an arrangement creates a fundamental unfairness with regard to any conceivable interpretation of the Internal Revenue Code and more es-

pecially so, where such an interpretation does violence to the plain statutory language of Section 6303(a).

It should be noted that in the instant case, without the benefit of the extended statute of limitations, that the entire suit brought by the Government would be a nullity. The last assessment against Pennmount was made for the tax quarter ending March 31, 1980, with notice of assessment given to Pennmount on July 14, 1980. (J.A. 5-7, Pet. App. 45a). The Government did not file suit in the district court against the Bank until December 30, 1983, more than three years after the period for suit would have elapsed absent the extension of the statute of limitations against the lender provided for under Section 6502(a) of the Code. (J.A. 3).

As further noted by Judge Weis in his dissent:

"It bears mentioning that the dispute here is not about a meaningless formality. The assessment of taxes against Pennmount had the effect of enlarging the statute of limitations against defendant bank for six years. 26 U.S.C. § 6502(a)1. *United States v. Associates Commercial Corp.*, 721 F. 2d 1094, 1097 (7th Cir. 1983). The likelihood of prejudice because of the loss or destruction of records by one secondarily liable is real and substantial. *United States v. Associates Commercial Corp.*, 548 F. Supp. 171, 174 (N.D. Ill. 1982)." (Pet. App. 23a).

B. The Eleventh Circuit has required notice of a tax assessment to be given to a third party lender.

The Eleventh Circuit Court of Appeals in *United States v. Merchants National Bank of Mobile*, 772 F. 2d 1522 (11th Cir. 1985) (per curiam), petition for *cert. pend-* ing to No. 85-1480 has likewise adopted the rationale of

the Seventh Circuit in *Associates*, supra. The Court reviewed the decision in *Associates*, stating:

"The United States argues on appeal that it was not required to give MNB the § 6303(a) notice of assessment as a prerequisite to suit against MNB for Dri-Mix's unpaid employment taxes. The Seventh Circuit, in *Associates Commercial Corp.*, rejected an identical argument. In that case, the court noted that § 6303(a) 'requires that notice of an assessment of unpaid taxes must be provided to "each person liable for the unpaid tax" within sixty days after the assessment was made, unless otherwise provided by the Internal Revenue Code.' 721 F. 2d at 1098. Since § 3505 did not exempt from § 6303(a) lenders potentially liable, and since no other exemption could be found, the court concluded that the lender, a 'person liable for the unpaid tax' within the meaning of § 6303(a), was entitled to notice of assessment of the unpaid tax. 721 F. 2d at 1098. The court held that the government's failure to provide the statutorily required notice barred its suit. *Id.* We agree with the Seventh Circuit's reading of the applicable statutory provisions and hold that the United States' failure to provide MNB with the § 6303(a) notice bars the present suit against MNB.'" 772 F. 2d at 1523-24. (footnote omitted)

Jersey Shore is not suggesting that Section 6303(a) should be interpreted in such a manner as to make a fortress out of the dictionary. The interpretation urged by the Government, however, results in less procedural protection to a third party taxpayer who is being held liable for the tax than to the employer. This interpretation would extend the statute of limitations against the lender for an additional six years without affording the lender the same statutory notice of the tax liability as the primary taxpayer receives. Such an interpretation com-

pletely vitiates the plain language of Section 6303(a) without any legislative history showing a Congressional intent to the contrary.

III. THE SUBSTANTIVE REQUIREMENTS OF SECTION 3505 LIABILITY DO NOT OBVIATE THE REQUIREMENTS OF NOTICE TO A THIRD PARTY LENDER UNDER SECTION 6303(a)..

The Third Circuit in its opinion in this case and the Ninth Circuit in the case of *United States v. Hunter Engineers & Constructors, Inc.*, 789 F. 2d 1436 (9th Cir. 1986), both relied upon the substantive requirements for Section 3505 liability in order to justify their view that no notice of a tax assessment was required to be given to a third party lender pursuant to Section 6303(a) of the Code.

The Third Circuit in the instant case noted:

“Careful consideration of the substantive requirement of section 3505 further buttresses our conclusion that section 6303(a) does not require notice to parties like Jersey Shore. In construing section 6303(a) to require notice to third parties like Jersey Shore, the Seventh Circuit was apparently concerned that unless such notice be given, third parties like Jersey Shore would have no reason to suspect that they be liable under section 3505, to their ultimate prejudice. See 721 F. 2d at 1099-1100. A similar concern has been voiced by other courts that have addressed this question. See, e.g., *United States v. American Bank & Trust*, No. 84-5624, slip op. at 4-5 (E.D.Pa. Aug. 9, 1985) (observing that ‘any potential burden [on the government] is outweighed by the possibility of prejudice to the lender not receiving notice’); *United States v. Associates Commercial Corp.*, 548 F. Supp. 171, 174 (N.D. Ill. 1982).

“However, in light of the burden of proof placed upon the government by section 3505, we find this concern to be generally unfounded.” (Pet. App. 17a-18a).

The Ninth Circuit likewise noted:

“While we agree that this statutory scheme does not wholly negate the possibility of prejudice to the lender, it is clear that Congress sought to impose liability only when the government could meet its burden of proof under section 3505. Thus, we conclude that a lender who is liable under section 3505 must have necessarily been intimately involved in the employer’s failure to pay taxes and consequently does not need formal notice of such liability to enable it to defend itself in a subsequent action.” *Hunter Engineers & Constructors, Inc.*, *supra*, at 1441.

Such an analysis clearly includes within it as a logical predicate the belief that the lender is liable for the tax in the first instance and therefore suffers no prejudice by virtue of not having received notice of assessment of the tax under Section 6303(a). The lender therefore is not prejudiced by being sued up to nine years later by the Government after the tax has been assessed against the employer.⁵ While this may be true in the case of a lender who in fact is liable under Section 3505, the question arises as to what effect the lack of notice has on the innocent lender.

⁵For example, if a lender makes a loan at the beginning of a quarterly period, the employment tax return would not be due until four months after the start of the quarter. Treas. Reg. § 31.6071(a)-1. The Government would then have three years from that date within which to make the assessment for unpaid taxes. 26 U.S.C. § 6501(a). After the assessment, it would have an additional six years within which to institute suit against the lender under Section 3505. 26 U.S.C. § 6502(a).

The corporate officers of a financially ailing or bankrupt company will have a great interest in reconstructing their recollection of past events in order to foist liability for taxes on a lender under Section 3505. Obviously, in the situation where the Government is proceeding to collect past due taxes, the interests of corporate officers facing potential liability under Section 6672 of the Code are diametrically opposed to that of an innocent lender on whom the Government is seeking to place liability for the taxes under Section 3505. *See: United States v. American Bank and Trust, supra*, appeal pending to No. 85-1615 (3rd Cir.). The testimony of the corporate officers can best be rebutted by the testimony of the lender's loan officers. However, given the passage of time many of the loan officers in any financial institution will have moved, changed jobs and may be unable to be located or may have died.

Nine years later when the Government returns to sue the lender, recollections of loan transactions may be inexact; more particularly so in the case where the lender is not culpable and would have no reason to believe that it faces liability for someone else's taxes under Section 3505.

The only way to prevent this situation from arising is to require the Government to adhere to the statutory mandate of Section 6303(a) giving the lender, as well as the employer, notice of the tax assessment.

IV. NOTICE OF ASSESSMENT IS A NECESSARY STEP WHICH THE GOVERNMENT MUST FOLLOW IN ITS COLLECTION PROCESS AGAINST A THIRD PARTY LENDER.

A No undue administrative burden would be placed on the Government in complying with the notice provisions of Section 6303(a).

The Government argues that requiring notice of a tax assessment to be given to third party lenders would impose an undue administrative burden on the IRS (Pet. App. 19a-22a). The argument of the Government, however, ignores the provision of Section 6501(a) of the Code which allows the IRS three years from the time that the employer's tax return has been filed to impose an assessment against the taxpayer (Pet. App. 51a). Accordingly, the period for investigation which the Government argues is impossible to perform within sixty days is inapplicable, inasmuch as the Government has three years to file the assessment against the employer before the running of the sixty day notice period begins. It is during the latter time that adequate investigation could be made by the Government with regard to third party lenders whom the Government wishes to hold liable under Section 3505 of the Code.⁶

⁶See Gombinski, *A Noticeable Restriction: Imposing Section 3505 Liability After Associates*, 62 Taxes—The Tax Magazine 757 (Nov. 1984), where it is noted: "Since Section 6501 would allow the government to make this separate assessment any time within three years from the date that the employer's tax return is deemed to be filed, the government would be afforded reasonable time in which to determine the existence of those lenders who may be liable for the employer's unpaid tax." *Id.* at 770.

The provisions of Section 3505 of the Code imposing liability on third party lenders constitute an extraordinary remedy which Congress enacted in favor of the Government to hold third parties liable for unpaid taxes. H. R. Rep. No. 1884, 89th Cong., 2d Sess. at 20-21; S. Rep. No. 1708, 89th Cong., 2d Sess. at 21-23.

No exception is present in Section 6303(a) to indicate that persons whom the Government seeks to hold liable under Section 3505 should not be given notice of the tax assessment.

Likewise, if one accepts for purposes of argument the Government's contention that an assessment could not be statutorily made against the Bank for Pennmount taxes, the issue of the notice of the assessment is still present. (Pet. App. 12a-13a). The central issue in the present case is notice of the assessment to a third party, *i.e.* the Bank, whom the Government seeks to hold liable for the tax of the employer, and not the assessment itself.

As a policy matter, providing timely notice to a lender of an assessment against an employer would put the lender on notice of liability and allow the lender to evaluate its ongoing relationship with the borrower. In the present case the first notice of liability that Jersey Shore received was the filing of the lawsuit in District Court, almost six years after the first tax liability arose. (Pet. App. 34a).

Obviously, if the Government is seeking to eliminate unpaid tax liabilities, the best place to begin would be to provide the third party lender with notice of the fact that the employer has failed to make payment of withholding and FICA taxes. The lender could then take steps to monitor the employer's payment of these taxes, or al-

ternately, could stop funding the employer completely, thereby eliminating the accrual of unpaid taxes.

Additionally, under Section 6204 of the Code the Government is allowed to make a supplemental assessment where a prior assessment is imperfect or incomplete "in any way." Under Section 6204 such assessment would allow the Government to in effect reassess the tax against the employer and provide the lender with timely Section 6303(a) notice of the additional assessment. The Government would in such event have three years after the tax return of the employer is filed in order to make a determination with regard to potential liability of a lender, make a supplement assessment and then an additional sixty days afterwards to provide the lender with notice of that supplemental assessment.⁷

Finally, if the Government still feels aggrieved by the notice requirement of Section 6303(a), it could petition Congress to change the statute and not ask the Court to make a strained interpretation of the plain meaning of the statutory language of Section 6303(a).

B. The Ninth Circuit misconceived the nature of the notice requirement under Section 6303(a).

The Ninth Circuit in *Hunter Engineers & Constructors, Inc., supra*, followed the rationale of the Third Circuit holding that no notice was required to be given to a lender under Section 6303(a) of the Code in order for the Government to impose liability upon such lender pursuant to Section 3505.

The Ninth Circuit adopted the reasoning of the Third Circuit noting that:

⁷See: Gombinski, *supra* at 771.

"Section 6303(a) states that 'each person liable for the unpaid tax' shall be given notice within sixty days of assessment. 26 U.S.C. § 6303(a) (1982). It does not provide that only 'taxpayers' or 'persons assessed against' are to be given notice. Further, the government does not contend that Congress 'otherwise provided,' that notice need not be given to lenders who are liable for taxes assessed against an employer. If section 6303(a) required nothing more than notice 'to each person liable for the unpaid tax,' we would be persuaded that such clear and unambiguous language 'be regarded as conclusive.' *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). But the statute also requires the notice to state the amount owing and to make demand for payment. 26 U.S.C. § 6303(a). The court in *Jersey Shore* found these added requirements to be significant in determining the intent of Congress. *Jersey Shore*, 781 F. 2d at 978." *Hunter Engineers & Constructors, Inc.*, *supra*, at 1438.

The Ninth Circuit, however, did not address the fact that Section 6303(a) of the statute specifically does not provide the form of the notice which must be given "to each person liable for the unpaid tax." It is submitted that it is only the Government's own construction of the statute which prevents a third party lender from receiving notice of the assessment. Clearly any third party lender could receive notice from the Government that an assessment had been made against an employer for a designated amount of unpaid taxes and indicating demand for payment with the statutory liability of the lender set forth under Section 3505 of the Code.

Such notice of assessment would put the innocent lender on notice that the Government had the statutory right to seek collection of the tax from the lender as well as the employer. The lender would then be able to take steps to protect itself including the assembling of records

and making a determination as to whether or not it intended to extend further credit to the employer, knowing that the employer had failed to pay his FICA taxes and employee withholding taxes to the Government.

It should be noted that the Government is not relegated under the Code from seeking collection against the employer first, but has a choice of options as to proceeding against the employer, the lender, or potentially corporate officers of the employer as well under Code Section 6672.⁸ Given notice as required under Section 6303 (a), the lender may avoid the unfortunate situation in which the Government returns to seek collection of employer taxes against an innocent lender up to nine years after the tax has been assessed, with the first notice that the lender now receives being the lawsuit filed against it in the district court by the Government. The lack of notice is particularly unfair to the lender in the situation where the corporate employer has gone bankrupt as in the instant case and the chief corporate officer is no where to be found when the Government returns to seek collection of the corporate tax against the lender. (Pet. App. 47a; doc. no. 17, Glossner deposition at 30).

The Ninth Circuit also misconstrued the requirement of providing notice of an assessment to a third party taxpayer under Section 6303. The Ninth Circuit found that:

"Aside from congressional intent, we conclude that a shorter limitations period for lenders than employers would serve to thwart the government's efforts to collect the tax liabilities from the employer. The government would be forced to file an action against

⁸In the present case there is no record that the Government first attempted to collect the tax liability from corporate officers of Pennmount utilizing Section 6672 of the Code before proceeding against Jersey Shore.

the lender within three years of the assessment even if collection efforts against the employer were ongoing." *Hunter Engineers & Constructors, Inc., supra*, at 1441.

Such an argument, however, misinterprets the relationship between Section 3505 and Section 6303(a) under either position argued by third party lenders or the Government. The Government is urging that no notice of an assessment should be required in order to extend the statute of limitations period against the lender. The Bank, as petitioner in the present case, is requesting that notice be provided to a third party lender under Section 6303 (a) in order to justify the extended statute of limitations period. The Bank, as a third party lender, is not requesting special treatment differing from that afforded an employer with regard to the extended statute of limitations. The Bank does not wish to see a shorter statute of limitations period applicable to it as opposed to an employer. What the Bank is asking for, however, is that it be accorded the same treatment as an employer receives with regard to the issue of notice. As a matter of fairness and statutory right, the Bank is entitled to receive notice of the tax assessment at the same time that the employer does in order for the Government to have the right for the statute of limitations to be extended against the Bank for an additional six year period after the assessment is made.

V. THE THIRD CIRCUIT MISAPPREHENDED THE LEGISLATIVE HISTORY OF SECTION 3505 WITH THAT OF THE MILLER ACT, 40 U.S.C. § 270a (d).

The majority opinion of the Third Circuit misapprehended the legislative history with regard to the enactment of Section 3505 of the Code. The opinion in interpreting the meaning of Section 3505 of the Code made

reference to the Congressional Reports of the Senate and House, quoting the language from those sections of the reports which related not to the enactment of Section 3505 of the Code but to the amendment to Section 1 of the Miller Act, 80 STAT. 1139, 40 U.S.C. § 270a(d), referencing the requirements for performance bonds on public works. (Pet. App. 18a-19a). The latter amendment was enacted as part of the Federal Tax Lien Act of 1966, *supra*, which also included enactment of Section 3505 of the Code.

The majority opinion noted: "Although we do not intend to downplay the potential burden resulting from our construction of section 6303(a), we find the legislative history of section 3505 quite instructive on the question of prejudice to parties like Jersey Shore." (Pet. App. 18a).

In enacting the amendment to Section 1 of the Miller Act, *supra*, Congress plainly provided for notice to be given to a surety of unpaid employer taxes in order for the surety to be held liable on its bond. (Pet. App. 52a). Obviously, Congress in enacting the aforesaid amendment to the Miller Act was cognizant of the prejudice which would result to a surety on its bond without prior notice of unpaid employer taxes.

Congress at the same time in enacting Section 3505 of the Code had already provided for notice to third party lenders by virtue of the requirement of Section 6303(a) of the Code mandating notice of the assessment to "each person liable for the unpaid tax."

The amendment to the Miller Act clearly evidences a Congressional concern that a third party should not be

held liable for taxes of an employer without having received advance notice of the unpaid taxes.

While the legislative discussion in the House and Senate Reports regarding Section 3505 of the Code appears in part E1 of the reports, the language cited by the Third Circuit in the instant case, is contained in part E2 of both the House and Senate Reports which discuss the amendment to the Miller Act, *supra*. (Pet. App. 18a-19a).

The language of the amendment to the Miller Act requiring performance bonds from contractors in order to insure payment of government taxes associated with payrolls, comports with the view expressed in the majority opinion of the Third Circuit that sureties and lenders are in essence the better risk bearers to include the costs of potential payroll tax liabilities in their premiums or as part of their loan security. (Pet. App. 18a-19a). Such an interpretation would be consistent with the performance bond requirements of the Miller Act, *supra*, when sureties are acting as obligors on a bond, or lenders are acting as guarantors of payroll taxes on a loan.

The language from the House and Senate Reports as quoted by the Third Circuit does not comport, however, with its interpretation of the Congressional purpose in enacting Section 3505 of the Code. (Pet. App. 18a-19a). As the Third Circuit notes, liability under Section 3505 of the Code arises when the lender has actual knowledge that the employer does not intend to or will not pay over the taxes required to be withheld, or alternately, is itself directly paying net wages without payment of the payroll taxes. (Pet. App. 18a). The question arises as to why, given such a scienter requirement under Section 3505,

would the Senate and House Reports quoted by the Third Circuit, purportedly as an interpretation of Section 3505 of the Code, indicate that lenders could protect themselves against such losses attributable to withholding taxes "by their including the amounts in their loans and taking adequate security." (Pet. App. 18a-19a, citing S. Rep. No. 1708 at 23; H.R. Rep. No. 1884, at 22).

If the language of the legislative history cited in the Third Circuit opinion in the instant case applies to Section 3505, then the above referenced language in the reports is not logical inasmuch as there would be no need for lenders to include tax liabilities in their loans, as liability for such payroll taxes could never result under Section 3505 absent some volitional cognitive act on the part of the lenders with regard to the nonpayment of payroll taxes of a contractor.

Inasmuch as such an interpretation results in a nullity, it is submitted that the language cited by the Third Circuit from the House and Senate Reports actually is a commentary on the amendment to Section 1 of the Miller Act, *supra*, with reference to performance bonds required to be furnished by contractors. Indeed the sections of both the House and Senate Reports where the commentary cited by the Third Circuit appeals would support such a view. (Pet. App. 18a-19a). In such situations, it is obvious that when a surety provides a performance bond which includes a guarantee of payment of payroll taxes, or alternately, when a lender provides a performance bond by guaranteeing payment of payroll taxes under 40 U.S.C. § 270a(d), that both the surety and the lender are acting as guarantors of the taxes, thereby subjecting themselves to an absolute liability in the event that such taxes are not paid by the contractor. In this context, the surety can provide

protection by increasing the premiums on the performance bond, and the lender can likewise provide protection by increasing its loan fees and taking additional security to cover such potential loss.

Such absolute liability is not the case, however, under Section 3505. It is submitted therefore that the legislative history cited by the Third Circuit in the instant case does not support its interpretation of Section 3505 of the Code.

o

CONCLUSION

For the foregoing reasons, the petitioner, Jersey Shore State Bank, respectfully prays that this Court reverse the judgment of the court of appeals and order reinstatement of the judgment of the district court.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1986

JERSEY SHORE STATE BANK, PETITIONER

v.

UNITED STATES OF AMERICA

**ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Section 3505 of the Internal Revenue Code provides that, where a lender furnishes funds directly or indirectly to an employer for the payment of wages, the lender in certain circumstances may be personally liable if the required employment taxes are not withheld from those wages and paid over to the IRS. The question presented is whether, as a prerequisite to the government's maintenance of a civil suit to collect the lender's personal liability in such circumstances, the IRS must have sent to the lender, within 60 days of making an assessment of the unpaid taxes against the employer, a copy of the tax bill that is required to be sent to the employer under Section 6303(a).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-24a) is reported at 781 F.2d 974. The opinion of the district court (Pet. App. 27a-37a) is reported at 628 F. Supp. 15.

JURISDICTION

The judgment of the court of appeals was entered on January 10, 1986. A petition for rehearing was denied on February 4, 1986 (Pet. App. 25a-26a). The petition for a writ of certiorari was filed on April 22, 1986, and was granted on June 2, 1986. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

(1)

STATUTES INVOLVED

The relevant portions of Sections 3505 and 6303 of the Internal Revenue Code of 1954 (26 U.S.C.) are set forth at Pet. App. 50a-51a.

STATEMENT

1. The Internal Revenue Code imposes a number of "employment taxes," set forth in Subtitle C of the Code. See I.R.C. §§ 3101-3510.¹ These taxes include the social security or FICA tax (I.R.C. §§ 3101-3126) and the income taxes that are withheld from employees' wages at the source (I.R.C. §§ 3401-3406).² The social security tax is imposed on the employer and the employee alike, with each being required to pay roughly half the overall tax. See I.R.C. §§ 3101 and 3111. The withheld income tax, representing a current payment on account of the employee's annual liability, is of course borne solely by the employee. See I.R.C. §§ 3401 and 3402.

Subtitle C places two basic obligations on employers with respect to these taxes. The employer is required to pay the employment taxes imposed directly on him, such as his share of the social security tax. See I.R.C. § 3111. The employer is also required to withhold from his employees' wages, and pay over to the IRS, the employment taxes that are imposed on the employees, such as the withheld income tax and the employees' share of the social security tax. See

¹ Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

² Other Subtitle C taxes, such as the Federal Unemployment Tax (I.R.C. §§ 3301-3311) and the Railroad Retirement Tax (I.R.C. §§ 3201-3233), are not involved here.

I.R.C. §§ 3102(a) and (b), 3403, 3501. These latter taxes are usually called "withholding taxes." The employer in essence serves as a collection agent for the government with respect to these amounts; after collecting the taxes from the employees' salaries, the employer is required to hold those sums in trust for the government until they are paid into the Treasury at designated times. See I.R.C. §§ 3102(a) and (b), 3403, 3501(a), 7501.

If an employer fails to satisfy its obligations with respect to withholding taxes, the Code provides several alternatives that the IRS may use to collect such funds. The Commissioner of course may collect withholding taxes directly from the employer, who is explicitly made liable therefor. See I.R.C. §§ 3102(b), 3403. In recognition of the special "trust fund" status of withholding taxes, however, the Code affords the Commissioner a number of particularized collection remedies. One of these is set forth in Section 6672, the so-called "responsible officer" provision. Under that provision, corporate officers or other persons responsible for the collection and payment of withholding taxes incur a personal liability, in the form of a penalty equal to 100% of the unpaid taxes, if they willfully fail to satisfy those responsibilities. See I.R.C. § 6672(a).

Another remedy for collecting unpaid withholding taxes is set forth in Section 3505. Under Section 3505(a), "a lender, surety, or other person" who pays wages directly to the employees of another employer is "liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages." A lender or other third party is also subject to such personal liability if it supplies

funds to an employer for the specific purpose of paying wages "with actual notice or knowledge * * * that such employer does not intend to or will not be able to make timely payment or deposit" of the requisite withholding taxes (I.R.C. § 3505(b)). In the latter case, the third party's liability is limited to 25% of the aggregate amount that it supplied to the employer (*ibid.*). Section 3505 was enacted by Congress to discourage a practice known as "net payroll financing," under which lenders who undertook to satisfy an employer's payroll obligations would supply funds necessary to meet only the net amounts due to the employees, and no one would pay over the withholding taxes due to the government. See H.R. Rep. 1884, 89th Cong., 2d Sess. 20 (1966); S. Rep. 1708, 89th Cong., 2d Sess. 21-22 (1966).

2. Petitioner is a bank with its principal place of business in Jersey Shore, Pennsylvania (Pet. App. 28a). Beginning in early 1976, petitioner provided a total of approximately \$290,000 to finance the operations of Pennmount Industries, Inc., a financially troubled company engaged in the business of manufacturing furniture. From the fourth quarter of 1977 through the first quarter of 1980, Pennmount failed to pay over to the IRS the income and social security taxes withheld from its employees' wages. Pennmount also failed to pay the employer's portion of social security taxes that it owed (Pet. App. 28a). The Commissioner made an assessment against Pennmount for each of these 10 quarterly periods, as well as other quarters not involved here.³ These assess-

³ An "assessment" is the recording by the Internal Revenue Service on its books of the taxpayer's liability for taxes. See I.R.C. § 6203. It is a statutory prerequisite to summary collection methods such as levy and distraint. See I.R.C. § 6331.

ments reflected Pennmount's liability for the various unpaid employment taxes (*id.* at 39a, 43a-45a).

Section 6303(a) of the Code provides that the Commissioner, as soon as practicable after making a tax assessment, and in any event within 60 days of making an assessment, must "give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof." The Commissioner typically provides such notice by sending the taxpayer a "Request for Payment of Balance Due"—in essence, a tax bill—notifying the taxpayer of the amount owed and requesting payment within 10 days. See M. Saltzman, *IRS Practice and Procedure* ¶ 14.03, at 14-11 *et seq.* (1981). On the same day that the Commissioner made each of the assessments against Pennmount, he sent Pennmount a notice pursuant to Section 6303(a) stating the amount of its unpaid employment taxes and demanding payment thereof (Pet. App. 43a-45a). In each instance, Pennmount failed to pay, in whole or in part, the assessed taxes. The total unpaid balance of the assessments is approximately \$116,000, plus interest (*id.* at 39a).

3. On December 30, 1983, the United States brought this action against petitioner in the United States District Court for the Middle District of Pennsylvania (Pet. App. 27a-28a). The government alleged that petitioner, beginning in October 1977, had lent funds to Pennmount under circumstances that rendered petitioner personally liable, under Section 3505 of the Code, in an amount equal to a portion of the employment taxes assessed against Pennmount (Pet. App. 2a, 38a-41a). Specifically, the government alleged (*id.* at 39a) that petitioner had "paid wages directly to Pennmount employees," thereby making it liable under Section 3505(a) for the full amount

of the unpaid withholding taxes. Alternatively, the government alleged (Pet. App. 40a-41a) that petitioner had supplied funds to Pennmount "for the specific purpose of paying * * * wages," with knowledge that Pennmount "did not intend or would not be able to make timely payments or deposits of the * * * taxes required to be deducted and withheld" from its employees' wages, thereby making petitioner liable under Section 3505(b) for the amount of unpaid withholding taxes up to 25% of the amount of funds supplied. The government alleged that petitioner's liability under Section 3505(a) was approximately \$76,500, plus interest, and that its alternative liability under Section 3505(b) was approximately \$72,000, plus interest (Pet. App. 2a, 40a-41a). In its answer, petitioner admitted making commercial loans to Pennmount, but denied any liability under Section 3505 (Pet. App. 3a, 46a-49a).

The government moved for summary judgment with regard to petitioner's liability under Section 3505(a) (Pet. App. 31a). Petitioner conceded liability under Section 3505(a) for the period from January 1979 through March 1980, but opposed summary judgment with respect to the earlier periods (Pet. App. 29a). Petitioner filed a cross-motion for summary judgment, however, contending that the United States was precluded from suing it for any of the periods in question because the Commissioner had not provided it with notice of the tax assessments against Pennmount within the 60-day period specified in Section 6303(a). Petitioner submitted that, if the instant suit were successful, it would be a "person liable for the unpaid tax" within the meaning of Section 6303(a). Petitioner accordingly argued that the Commissioner was required, within 60 days of

making the assessments against Pennmount, to send petitioner as well as Pennmount notice of the assessments in the form of the tax bill described in Section 6303(a) (Pet. App. 32a-33a; J.A. 8-9).

The district court granted petitioner's cross-motion for summary judgment (Pet. App. 27a-36a). Relying on *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983), the district court held that the notice and demand for payment specified in Section 6303(a) must timely be sent, not only to the taxpayer against whom the taxes in question have actually been assessed, but also to third parties against whom the United States might in future seek to establish liability in a civil suit under Section 3505 (Pet. App. 33a-35a). Because the government conceded that it had not notified petitioner of the assessments against Pennmount prior to the commencement of the instant suit on December 30, 1983 (*id.* at 32a), the district court held that the government's suit was barred (*id.* at 35a-36a).

4. The court of appeals reversed, one judge dissenting (Pet. App. 1a-24a). The court rejected petitioner's argument that the "plain meaning" of Section 6303(a) entitled it to receive notice of the assessment against Pennmount at the time Pennmount's taxes were assessed. Section 6303(a) speaks of "notice to each person liable for the unpaid tax"; at the time of the assessment against Pennmount, the court of appeals observed, Pennmount's lenders had only a "potential liability" with respect to the unpaid tax (Pet. App. 9a). The court also emphasized that Section 6303(a) "requires notice of a particular kind: i.e., 'one stating the amount and demanding payment thereof'" (Pet. App. 8a (emphasis in original)). The court pointed out that the notice of assessment

against the employer typically is not restricted to unpaid withholding taxes, but includes other amounts for which lenders under Section 3505 are not liable; thus, the tax bill sent to the employer would only fortuitously "stat[e] the amount" of the lender's potential liability. Pet. App. 9a (citing I.R.C. § 6303(a)). Moreover, notice to a lender that the IRS has assessed taxes against the employer would not "demand payment" from the lender, since the lender would not be expected to pay, and could not be required to pay, the tax at that time (Pet. App. 9a-10a). The court of appeals therefore found "the government's construction of the statute the more natural and logical reading of the language: i.e., section 6303(a) requires notice only to those individuals against whom the taxes have been assessed" (Pet. App. 10a).

The court then explained that its reading of Section 6303(a) served the evident purpose of the statute's notice requirement (Pet. App. 11a-17a). The Code provides two distinct methods for the collection of taxes: (1) by administrative means, such as levy and distraint, following an assessment; and (2) by means of a civil suit. In the case of administrative collection, the court observed, "the need for the notice provided by section 6303(a) and its predecessor statutes is readily apparent," since, upon assessment and demand, all of the taxpayer's property becomes subject to a tax lien and to summary collection by levy or seizure. Pet. App. 11a-12a (citing I.R.C. §§ 6321 and 6331). The notice provided under Section 6303(a) thus protects the taxpayer by giving him the opportunity, by promptly paying the assessed tax, to take steps to avoid the possibility of a levy on his property. Under Section 3505, however, the government cannot

collect the tax administratively, but must proceed by a civil suit, so that the third party is in no danger of having his property seized to satisfy the obligation. In such circumstances, "service of the government's complaint provides the party with all the notice and protection required" (Pet. App. 13a).

The court also observed that the notice sought by petitioner would "serve[] no useful purpose" but would simply interpose a "formalistic requirement" on which lenders might rely to "thwart[] Congress' intent to recover the unpaid withholding taxes" from them (Pet. App. 18a). The court rejected as "unfounded" (*ibid.*) the concern that lenders might be prejudiced absent such notice because they might not otherwise suspect that they ran the risk of Section 3505 liability. The court explained that Section 3505 requires the government to prove that the lender was "actually or constructively aware of its potential liability for the taxes" at the time it advanced funds to the financially distressed employer (Pet. App. 18a (emphasis omitted)). Thus, the Section 6303(a) notice would "communicate[] no additional information" to the lender because it would tell him nothing that he did not already know (Pet. App. 18a). Finally, the court of appeals emphasized that requiring the IRS to notify lenders under Section 6303(a) "would impose a prohibitory investigative burden on the government" (Pet. App. 20a) that would render Section 3505 "a substantial nullity" (Pet. App. 21a).

Judge Weis dissented (Pet. App. 21a-24a). In his view, the plain language of Section 6303(a) required that notice be given to the lender. He acknowledged that the reasons advanced by the government for its reading of the statute "have some logic and would possibly ease administrative burdens on the govern-

ment" (*id.* at 22a), but he believed that those arguments should be addressed to Congress, not the courts.

INTRODUCTION AND SUMMARY OF ARGUMENT

Congress enacted Section 3505 in 1966 (Federal Tax Lien Act of 1966, Pub. L. No. 89-719, § 105(a), 80 Stat. 1138) in response to a practice generally known as "net payroll financing," which was especially common in the case of employers experiencing financial difficulties. H.R. Rep. 1884, *supra*, at 20; S. Rep. 1708, *supra*, at 21-22. Under that practice, a third party—typically a surety, bank, or general contractor—would supply the employer with funds for the payment of wages, or pay wages directly to the employees, thereby keeping the employer afloat. In order to limit its own exposure, however, the lender would supply an amount equal only to the "net," or after-tax, wages due the employees, without paying, "either to the employees or to the Government, the withholding taxes due the Government." H.R. Rep. 1884, *supra*, at 20; S. Rep. 1708, *supra*, at 21. See *United States v. Coconut Grove Bank*, 545 F.2d 502, 505 (5th Cir. 1977); *United States v. Algernon Blair, Inc.*, 441 F.2d 1379, 1381 (5th Cir. 1971). Employees receiving such "net wages" were entitled (then as now) to a credit against their own tax liabilities for the taxes required to be withheld, regardless of whether the employer actually paid the taxes over to the United States. See 26 U.S.C. (1964 ed.) 31(a).

Although employers in such circumstances technically remained liable for the unpaid withholding taxes, Congress found that they were "likely to be without financial resources and, as a result, [that] recourse against them [might] well be fruitless."

H.R. Rep. 1884, *supra*, at 20; S. Rep. 1708, *supra*, at 21. Under pre-1966 law, moreover, recourse could not be had against the lender either, because the lender ordinarily would not have been deemed to be an "employer," as defined by statute, with respect to the withholding taxes. *Ibid.* Congress in 1966 acted to stem the resulting loss of revenue by addressing this latter problem directly. It enacted Section 3505 to impose personal liability upon third-party lenders who engage in net payroll financing, concluding that such lenders "sit in essentially the same position vis-a-vis control over payroll funds and access to information as the employer itself" (Pet. App. 6a). See H.R. Rep. 1884, *supra*, at 20; S. Rep. 1708, *supra*, at 22.

Petitioner concedes that it engaged in net payroll financing and that it is liable under Section 3505 for at least part of Pennmount's unpaid withholding taxes. Petitioner contends, however, that the government is barred from suing to collect this Section 3505 liability because the Commissioner failed to send it a copy of the tax bill that was sent to Pennmount at the time Pennmount's taxes were assessed. There is a split in the circuits on the question whether the notice specified in Section 6303(a) must be sent to lenders in such circumstances. Compare *United States v. Messina Builders & Contractors Co.*, No. 85-2505 (8th Cir. Sept. 23, 1986) (notice required), *United States v. Merchants Nat'l Bank*, 772 F.2d 1522 (11th Cir. 1985), petition for cert. pending, No. 85-1480 (same), and *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983) (same), with *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d 1436 (9th Cir. 1986), petition for cert. pending, No. 86-209 (notice not required).

The Third Circuit below correctly held that Section 6303(a) does not require notice to lenders of the assessment against the employer, and that the Commissioner's failure to provide such notice in any event does not prevent the United States from bringing a civil action against the lender under Section 3505. The terms of Section 3505 impose upon a lender not a liability for a tax, which could be collected administratively, but rather a liability "in a sum equal to the taxes" required to be withheld from the employees' wages—a personal liability that can be collected only by a civil suit instituted by the Department of Justice. See I.R.C. §§ 3505(a) and (b), 7401; H.R. Rep. 1884, *supra*, at 65-66. Adoption of the notice requirement that petitioner seeks would lead to an irrational result, for it would require the IRS, when making an assessment against a taxpayer, to notify a group of third parties whose identities the IRS typically would not know at the time. This notice would take the form of a tax bill that those parties would not then be expected to pay, and that bill would be in an amount that would rarely if ever correspond to any liability that the government might seek to impose in a future Section 3505 civil suit. If petitioner's contention were accepted, it would place such an enormous administrative burden on the government as a precondition to imposing Section 3505 liability that the provision would be nullified as a practical matter, with attendant frustration of Congress's goal to eradicate the practice of net payroll financing. And this untoward result would yield no countervailing benefits—other than windfalls to culpable lenders—because the notice petitioner seeks would be an empty formality that would convey no useful information to potentially liable third parties.

Petitioner's argument for this perverse result is grounded exclusively in a distorted reading of the text of Section 6303(a). A careful reading of that statute, however, coupled with consideration of its legislative history and underlying purposes, confirms the court of appeals' conclusion that Section 6303(a) requires notice only to the taxpayer or taxpayers against whom the assessment is made, and not to third parties who might have a liability (under Section 3505 or otherwise) for all or part of the amounts assessed. Petitioner's contention, finally, is directly contrary to the well-settled proposition that a notice of assessment is not a prerequisite to a civil suit by the United States to recover unpaid taxes.

ARGUMENT

NOTICE TO A LENDER OF AN ASSESSMENT OF DELINQUENT EMPLOYMENT TAXES AGAINST AN EMPLOYER IS NOT REQUIRED BY SECTION 6303(a) AND IN ANY EVENT IS NOT A PREREQUISITE TO A SUIT TO COLLECT THE AMOUNT OF DELINQUENT WITHHOLDING TAXES FROM THE LENDER UNDER SECTION 3505

A. The Terms Of Section 6303(a) Do Not Require That A Notice Of The Assessment Against The Employer Be Furnished To All Third Parties Who Might Be Liable For Withholding Taxes Under Section 3505

1. Petitioner's primary contention (Br. 7-10) is that the plain meaning of Section 6303(a) compels the conclusion that the Commissioner was required to give it notice of the assessment against Pennmount. As the court of appeals explained (Pet. App. 8a-10a), petitioner's argument is based on an incomplete and inaccurate reading of the statute. Section 6303(a) provides in pertinent part that the Commis-

sioner "shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to Section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof." In essence, Section 6303(a) requires the Commissioner to send to the taxpayer "a typical creditor's dunning letter" (Pet. App. 9a)—a tax bill demanding payment of a particular amount. See M. Saltzman, *supra*, ¶ 14.03, at 14-11 *et seq.* (reprinting sample IRS form letters).

Petitioner focuses exclusively on the portion of the statute requiring the Commissioner to give notice "to each person liable for the unpaid tax" and argues that, because the government is seeking to hold it liable in an amount equal to a portion of Pennmount's unpaid withholding taxes, it falls within this category and therefore must be given notice of the assessment of the tax delinquency. Examination of the complete text of Section 6303(a), however, demonstrates that this simplistic reading of the statute is erroneous. Section 6303(a) contemplates the giving of a particular form of notice—one "stating the amount [of the tax] and demanding payment thereof." The notice that petitioner contends must be sent to it (see Pet. Br. 5, 8, 24)—a copy of the tax bill that is being sent to the assessed employer—does not meet the statutory requirements. It neither sets forth the amount due from the third party nor demands payment of any tax by the third party. Accordingly, the "plain language" of the statute cannot be said to require that third parties potentially liable under Section 3505 be furnished with the notice of assessment mailed to the employer.

First, the notice of assessment sent to the employer only rarely, if ever, will set forth the amount

for which the third party is potentially liable. In almost every case, an employer who has not paid withholding taxes will not have paid the employer's portion of social security taxes either. See page 2, *supra*. The tax bill sent to the employer will demand payment of these latter taxes, but a lender can have no Section 3505 liability for them because they are obligations of the employer, not "taxes * * * required to be deducted and withheld from [the employees'] wages" (I.R.C. § 3505(a) and (b)). See H.R. Rep. 1884, *supra*, at 21 (a lender "is not liable for the employer's portion of payroll taxes"). Accordingly, the amount of tax due stated in the notice of assessment will not reflect an amount for which the third party may be personally liable. Moreover, even with respect to the withholding taxes owed by the employer, the notice may not reflect the magnitude of the third party's exposure because its Section 3505 (b) liability is limited to 25% of the funds that it advanced to the employer, so that in many cases the lender will not be liable for the full amount of the unpaid withholding taxes. Finally, unless the time period in which the third party paid net wages or financed a net payroll coincides exactly with the time period reflected in the assessment against the employer, the third party's potential liability will not coincide with the employer's withholding-tax liability. Because the tax bill sent to the employer will thus only fortuitously reveal the amount for which the third party is potentially liable, this notice does not provide to the third party the sort of notice contemplated by Section 6303(a).

Second, a notice that demands that the employer promptly pay the assessed tax does not correspond-

ingly demand payment from a third party who receives a copy of the notice. At the time the assessment is made, the government is seeking to collect from the taxpayer-employer, not from the lender, and the notice gives no indication of the likelihood that the government will, at some future time, bring a suit to collect the third party's liability under Section 3505. See *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d at 1439. Indeed, the Commissioner has no authority to "demand payment" from a third party when he makes an assessment against the employer; Congress has provided that a lender's liability under Section 3505 can be collected only in a civil suit instituted for that purpose by the Department of Justice. See I.R.C. §§ 7401, 7402. Thus, if one is "to give effect * * * to every word Congress used" (*Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979)), it is manifest that the notification to third parties desired by petitioner is not required by Section 6303(a), since the tax bill sent to the employer under Section 6303(a) neither "stat[es] the amount" nor "demand[s] payment" of the third party's potential liability.

In fact, even if one focuses solely on the short phrase in Section 6303(a) on which petitioner relies—the requirement that notice be given "to each person liable for the unpaid tax"—the language does not unambiguously support petitioner's construction of the statute. At the time of the assessment against the employer, the employer's lenders, as opposed to the employer itself, have not a present but only a "potential liability" (Pet. App. 9a) to pay the unpaid tax. The employer is obviously a "person liable" for the unpaid tax because the tax has been assessed against it; that assessment has the force of a judg-

ment that may be summarily collected, and it is ripe for immediate payment. See I.R.C. § 6331. A lender in petitioner's position, by contrast, could become liable to make a payment on account of the employer's unpaid tax only if the United States subsequently brings a civil action in which the lender's Section 3505 liability is established, a step that it is the Commissioner's current practice to recommend only if he is unable to collect the withholding-tax delinquency from other sources (such as the employer itself or its responsible officers). The speculative nature at the time of assessment against the employer of the lender's ultimate obligation to pay is evident from IRS estimates that Section 3505 comes into play in only about one case for every 5,000 withholding-tax delinquencies. See page 47, *infra*. Thus, because the lender's liability in practical terms is highly contingent at the time the Section 6303(a) notice is mailed to the employer, it is difficult to describe the lender at that moment as a "person liable" for the unpaid tax.

Moreover, even if a lender in petitioner's position were thought to be a "person liable," such a third party, technically speaking, is not a person liable "for the unpaid tax" (I.R.C. § 6303(a)). Section 3505 provides that a third party in certain circumstances "shall be liable in his own person and estate * * * in a sum equal to the taxes" specified therein; Section 3505 does not impose a tax or make the third party liable to pay another's tax. A third party sued under Section 3505 is subject to a distinct personal liability and hence is not literally a person liable "for the unpaid tax" that was assessed against the employer. See *United States v. Messina Builders & Contractors Co.*, slip op. 15 (Fairchild, J., dissenting). Finally, the phrase "the unpaid tax" as used

in Section 6303(a) obviously refers to the delinquent taxes specified in the notice of assessment. See I.R.C. § 6303(a), cross-referring to I.R.C. § 6203. As noted above, the third party will almost invariably not be potentially liable for the full amount stated in the notice of assessment. Rather, his exposure will be limited to an amount equal to a portion of "the unpaid tax."

In sum, the plain language of Section 6303(a) does not require that a notice of assessment against an employer be sent to a third party who might in future be held liable under Section 3505. Rather, as the court of appeals concluded (Pet. App. 10a), "the more natural and logical reading" of the statutory language is the construction that we urge—that Section 6303(a) "requires notice only to those individuals against whom the taxes have been assessed."⁴

2. The historical antecedents of Section 6303(a) support our view that its notice requirement contemplates notification to the party or parties against whom the assessment is made, not to third parties who in future may be held to have liability in an amount equal to some part of the unpaid taxes. The notice requirement historically has been linked to the assessment "list" that was compiled by the government. The current statute traces its origins back to

⁴ It is noteworthy that Section 6303(a) has never been interpreted to require that "responsible officers" or other persons liable for a "penalty equal to the amount of the [delinquent withholding] tax" (I.R.C. § 6672) receive notice of the assessment against the employer. Because the Code specifies that the liability under Section 6672 is to be "assessed and collected in the same manner as taxes" (I.R.C. § 6671(a)), these responsible persons do receive a notice of assessment, but only when a separate assessment is made against them.

the Revised Statutes of 1878. Section 3182 of the Revised Statutes required the Commissioner to make assessments of unpaid taxes and to "certify a list of such assessments when made to the proper collectors." Section 3184 of the Revised Statutes required the collector, "within ten days after receiving any list of taxes from the Commissioner * * * , [to] give notice to each person liable to pay any taxes stated therein, * * * stating the amount of such taxes and demanding payment thereof." Similar provisions were contained in the Internal Revenue Code of 1939, ch. 2, §§ 3640, 3641, 3655, 53 Stat. 442, 446. Section 3640 empowered the Commissioner to make assessments, Section 3641 directed him to "certify a list of such assessments when made to the proper collectors," and Section 3655 required the collector to issue a notice and demand for payment to "each person liable to pay any taxes stated therein" within 10 days after receiving a list from the Commissioner.⁵

⁵ While the Code today no longer provides for certification of an assessment list, the basic principles concerning the identity of persons against whom assessments are made remain unchanged from 1878. The assessment is made by "recording the liability of *the taxpayer*" (I.R.C. § 6203 (emphasis added)), and the regulations require that the record of assessment contain the identity "of *the taxpayer*" (Treas. Reg. § 301.6203-1 (emphasis added)). The taxpayer in this connection is the employer, the party against whom the assessment is made; a third-party lender potentially liable under Section 3505 does not come within the term "taxpayer" and cannot appear on the assessment list. See *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311, 1313 (9th Cir. 1979). Like its predecessors, Section 6303(a) necessarily draws a nexus between the assessment list and the notice requirement because that notice requirement is triggered by the making of an assessment "pursuant to section 6203."

These predecessor statutes of Section 6303(a), which closely tracked the present language, clearly contemplated that notice would be sent only to those persons who appeared on the assessment list, *i.e.*, to "each person liable to pay any taxes stated therein" (Rev. Stat. § 3184; 53 Stat. 446). As we have shown above, a third party in petitioner's position is not a "person liable to pay" the tax stated in the notice of assessment sent to the employer. And there is no indication that Congress, in reformulating these earlier provisions as Section 6303(a) of the 1954 Code, intended to make any change in the identity of the persons covered by the notice provision. Indeed, the legislative history demonstrates that the contrary is true (see pages 29-32, *infra*).⁶

⁶ Section 3505 of course had not been enacted at the time Congress reformulated the 1954 Code, and therefore Congress could not have been expected to address specifically in Section 6303 the possibility of giving notice to a third party potentially liable under Section 3505. But amicus First Alabama Bank is incorrect in stating (Br. 6) that there did not exist in 1954 any third-party liability that did not provide for separate notice and assessment. This Court had made clear in 1931 that the Commissioner could collect a transferee's liability by filing a lawsuit (*Phillips v. Commissioner*, 283 U.S. 589, 592 & n.2 (1931)), and, while the assessment of certain types of transferee liabilities was statutorily authorized (*e.g.*, Internal Revenue Code of 1939, ch. 2, § 311, 53 Stat. 90-91), transferee liabilities not covered by statute remained collectible only by civil action. Moreover, the government has always been empowered to collect delinquent taxes from a party that has contractually assumed the taxpayer's liability, even though it cannot assess the taxes against such a third party. See, *e.g.*, *United States v. Scott*, 167 F.2d 301 (8th Cir. 1948); cf. *United States v. John Barth Co.*, 279 U.S. 370 (1929) (suit against surety on taxpayer's bond to secure payment of taxes). Thus, there did exist in 1954 third-

B. The Policies Underlying Section 6303(a) Are Not Served By Construing It To Require Notice To Third Parties Potentially Liable Under Section 3505

The Internal Revenue Code provides several distinct methods for the collection of taxes. One is administrative collection by the IRS by means of levy and seizure. Under the Code, this method of collection must be triggered by an assessment, which, pursuant to Section 6303(a), is accompanied within 60 days by a notice and demand for payment.⁷ The

party liabilities that were not subject to separate assessment, and accordingly, contrary to petitioner's contention (Br. 11-13), the fact that Section 6303 at that time did not provide for notice of assessment to such third parties is significant in determining its meaning in the Section 3505 liability context.

⁷ "Notice and demand" under Section 6303(a) should not be confused with the "notice of deficiency" described in Section 6212 of the Code. A notice of deficiency is a pre-assessment document, applicable to income, gift, and estate taxes, that the IRS generally must provide taxpayers before it may assess or collect a "deficiency" in such taxes, *i.e.*, a liability greater than that shown on the taxpayer's return. See I.R.C. §§ 6211(a), 6213(a). The notice of deficiency gives the taxpayer the opportunity to petition the Tax Court to have his liability for the asserted deficiency redetermined. I.R.C. § 6214. If a notice of deficiency is sent and the taxpayer does not petition the Tax Court, or if he petitions and a Tax Court decision redetermining a deficiency has become final, the IRS then may assess the deficiency (see I.R.C. § 6213(a)) and send the taxpayer a notice and demand, *i.e.*, a bill, for those taxes. The notice-of-deficiency procedure has no application where a taxpayer has filed a tax return showing a liability, but has not fully paid that admitted liability. Such an unpaid tax is subject to immediate assessment, and the IRS may assess and proceed to collect any tax shown on a return. See I.R.C. § 6151(a). Moreover, the notice-of-deficiency procedure has no application to certain types of taxes, such as social security taxes, excise taxes, and withholding of income taxes. For

United States is also empowered to seek a judgment for any unpaid tax liability by bringing a civil action in district court. It is this second method that must be used to collect a Section 3505 liability (see, *e.g.*, H.R. Rep. 1884, *supra*, at 65-66), and it was, of course, this method that was employed against petitioner here. But the reasons for requiring the IRS to provide a notice of assessment have no relevance where a liability is sought to be collected by civil suit; such notice is necessary as a practical matter only when administrative collection is invoked. Hence, the Third Circuit's construction of Section 6303(a) not only gives effect to the complete text of the statute, but also represents the construction that gives effect to the rationale underlying the notice requirement.

1. Section 6203 of the Code provides that an assessment is made "by recording the liability of the taxpayer in the office of the Secretary." An assessment is simply "a bookkeeping notation * * * made when the Secretary or his delegate establishes an account against the taxpayer on the tax rolls" (*Laing v. United States*, 423 U.S. 161, 170 n.13 (1976)), and it "consists of no more than the ascertainment of the amount due and the formal entry of that amount on the books of the secretary." *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311, 1312 (9th Cir. 1979). While the assessment itself is thus a mere bookkeeping matter, the consequences that flow from the making of an assessment are quite significant. See generally M. Saltzman, *supra*, ¶ 10.01, at 10-2.

those taxes, the IRS may immediately assess and collect any additional taxes for which it has determined that the taxpayer is liable beyond the amounts shown on its return.

Once a tax has been assessed, the IRS is empowered to collect the tax using various summary methods of collection not involving resort to the courts. See *United States v. Rodgers*, 461 U.S. 677, 682-683 (1983); *Bull v. United States*, 295 U.S. 247, 259-260 (1935); see generally McGregor & Davenport, *The Collection of Delinquent Federal Taxes*, 28 So. Cal. Tax Inst. 589 (1976). The assessment automatically creates a lien against the taxpayer's property. See I.R.C. §§ 6321, 6322. If the taxpayer fails to pay the tax within 10 days after notice and demand, the IRS may levy against any property the taxpayer owns or on which a lien exists, and it may then sell the seized property (I.R.C. §§ 6331, 6335). And the government may file notice of the tax lien created by the assessment to protect its interest in the taxpayer's property against competing interests. See I.R.C. § 6323.

With limited exceptions, Section 7421(a) of the Code bars suits to enjoin the assessment or collection of taxes. Accordingly, once an assessment has been made, the taxpayer ordinarily has no recourse if he wishes to dispute his liability except to pay the tax and sue for a refund.⁸ And the taxpayer has no

⁸ If an assessment is improper because it has not been preceded by the issuance of a requisite notice of deficiency (see note 7, *supra*), the taxpayer may bring suit to enjoin summary collection pending government compliance with the statutory procedures. See I.R.C. §§ 6213(a), 7421(a); *Cool Fuel, Inc. v. Connett*, 685 F.2d 309, 313 (9th Cir. 1982). In addition, where the Commissioner is authorized to terminate the taxpayer's taxable year (I.R.C. § 6851) or to make jeopardy assessments (I.R.C. §§ 6861, 6862), the assessment is subject to judicial review under Section 7429. It is clear, however, that except in the extraordinary case where a taxpayer can demonstrate that "under no circumstances could the

power to prevent the IRS from levying against his property unless he promptly pays the tax. See generally *United States v. National Bank of Commerce*, No. 84-498 (June 26, 1985).

An assessment thus provides the IRS with powerful administrative tools that it may use to effect immediate collection from the taxpayer, without resort to the courts. Sections 6321 and 6331(a) of the Code, however, restrain the commencement of these collection measures by requiring the Commissioner to wait 10 days after giving the taxpayer "notice and demand" under Section 6303(a) before proceeding to levy on or seize his property. See I.R.C. § 6321 (providing that a tax lien arises if "any person liable to pay any tax neglects or refuses to pay the same *after demand*") (emphasis added); I.R.C. § 6331(a) (authorizing levy and distraint if "any person liable to pay any tax neglects or refuses to pay the same *within 10 days after notice and demand*") (emphasis added). The primary function served by the Section 6303(a) notice of assessment and demand for payment is thus to protect the taxpayer against unexpected seizure of his property. See *Pet. App. 12a; Macatee, Inc. v. United States*, 214 F.2d 717, 719 (5th Cir. 1954). Notice and demand permit him to make immediate payment (subject to later recovery in a refund suit) and thereby avoid embarrassment and other difficulties that may result from the recording of liens against, or the seizure of, his assets. Notice and demand also afford the taxpayer an op-

Government ultimately prevail" (*Enochs v. Williams Packing Co.*, 370 U.S. 1, 7 (1976)), the taxpayer cannot restrain the collection of assessed taxes simply on the ground that he does not in fact owe the taxes. That question must be litigated in a refund suit.

portunity to bring an immediate suit to restrain collection, if there exist the limited circumstances under which such suits are permitted (see note 8, *supra*). Thus, Congress reasonably concluded that fairness to taxpayers requires that Section 6303(a) notice and demand be provided to persons against whom an assessment has been made before summary administrative collection methods can be invoked.

2. When the Commissioner does not resort to summary administrative collection methods, however, but rather requests the Justice Department to commence a civil suit, "notice and demand" under Section 6303(a) play no significant role in the tax-collection process. The government is empowered to bring a collection action to obtain a personal judgment against a taxpayer for a tax due. See I.R.C. § 7401 (providing that such action can be commenced only with the concurrence of the Commissioner and at the direction of the Attorney General); 28 U.S.C. 1396 (establishing venue for such action). The power to bring a collection suit exists independently of any statutory authorization; it is based simply on the government's common-law right to sue on a debt. See, e.g., *United States v. Chamberlin*, 219 U.S. 250, 261 (1911); *Dollar Savings Bank v. United States*, 86 U.S. (19 Wall.) 227, 239-240 (1874). In the words of Judge Friendly, "in 1791 an action of debt lay in England for the collection of taxes, [and] such an action has always lain in the federal courts even apart from statute." *Damsky v. Zavatt*, 289 F.2d 46, 51 (2d Cir. 1961).

This judicial action to collect a tax debt is independent of the administrative collection process. It has long been settled that the government's failure to assess taxes does not preclude it from exercising its right to sue the delinquent taxpayer for those taxes.

See, e.g., *King v. United States*, 99 U.S. 229, 233 (1878); *Dollar Savings Bank v. United States*, 86 U.S. (19 Wall.) at 240-241; *Macatee, Inc. v. United States*, 214 F.2d at 717. Indeed, the government's right to collect taxes without assessment is expressly recognized in Section 6501(a) of the Code, which establishes a three-year statute of limitations for bringing a "proceeding in court without assessment for the collection of such tax," a period that may be extended if an assessment is made. When a civil suit is brought without an assessment, however, summary collection procedures (such as levy and distraint) are not available. Accordingly, there is no particular need to notify the taxpayer of the amount of his tax liability in advance of such a suit, or to make a prior "demand for payment" upon him, since there is no possibility of nonjudicial seizure of his property against which he must be warned. Rather, just as is the case with any other lawsuit, the filing of the complaint provides all the notice that the taxpayer needs to protect his interests.

For the same reasons, it would make little sense to extend the Section 6303(a) notice requirement to third parties who might conceivably be held personally liable under Section 3505. The government can take action to collect that liability only by filing a civil suit; the lender under no circumstances can be subjected to the risk of summary collection procedures that attend an assessment. See, e.g., H.R. Rep. 1884, *supra*, at 65-66.⁹ It is of course true that a

⁹ Amicus American Bankers Association appears to take the position (Br. 13) that the Commissioner is empowered to make an assessment directly against a third-party lender for its Section 3505 liability. It is surprising that amicus takes this position for, if it were so, it would make collection of Section

lender whom the government seeks to hold liable under Section 3505 is entitled to "some device which serves the same function of providing notice to the defendant that the filing of a lawsuit would" (American Bankers Ass'n Amicus Br. 7). But that "device" is already in place; it is, somewhat truistically, the filing of the government's lawsuit. The notice specified in Section 6303(a) would not really serve this function at all, since it would not tell the third party whether or not the government actually intended to collect on its Section 3505 liability, nor would it tell the third party what the amount of its potential exposure was likely to be. In short, the Section 6303(a) notice is designed to serve the specific purpose of demanding payment from the party against whom the assessment is made, informing him that he may be subject to summary collection procedures if he fails to pay at once. The notice loses its utility when extended beyond that context.

3. Petitioner's contention that Section 6303(a) requires notice to third parties is further belied by the well-settled rule that the Commissioner's failure to notify a taxpayer of an assessment does not bar suit by the United States to collect that individual's delinquent taxes. Even in cases where the IRS as-

3505 liabilities much easier. The Commissioner could simply make an assessment and levy on the funds of the presumably solvent bank; the government would then not need to go to the trouble of litigating a civil action in court. In fact, however, amicus's suggestion is plainly mistaken, as amicus First Alabama Bank points out (Br. 13 & n.7). There is simply no statutory authority for the Commissioner to assess a third-party lender for its Section 3505 liability. See pages 43-44, *infra*; *United States v. Dixieline Financial, Inc.*, 594 F.2d at 1313; but see *United States v. Messina Builders & Contractors Co.*, slip op. 11-12 & n.5.

sessed a tax but failed to provide the taxpayer with the notice and demand specified in Section 6303(a), the courts have held that this procedural error did not extinguish the taxpayer's liability or bar the United States from proceeding to collect that liability by a timely-filed civil suit. See *United States v. Erie Forge Co.*, 191 F.2d 627, 631 (3d Cir. 1951), cert. denied, 343 U.S. 930 (1952); *Jenkins v. Smith*, 99 F.2d 827, 828 (2d Cir. 1938). Those courts explained that an assessment, with its attendant notice requirement, is a prerequisite to the *administrative* collection process, so that the Commissioner's failure to give the taxpayer Section 6303(a) notice could well prevent the IRS from levying on the taxpayer's property. But an assessment—and a fortiori notice to the taxpayer of an assessment—"is immaterial in an action by the United States" because such a suit may be brought "‘upon the duty imposed by the statute alone,’" that is, upon the taxpayer's statutory obligation to pay his taxes. *Erie Forge*, 191 F.2d at 631 (quoting *Jenkins*, 99 F.2d at 828). Since the provision of Section 6303(a) notice to the taxpayer against whom the assessment is made is not a prerequisite to a civil suit to collect from him, it would be perverse to read into Section 6303(a) a congressional intent that the provision of such notice to a third party is a prerequisite to a civil suit to collect from that third party. Indeed, under the rule set forth in *Erie Forge* and *Jenkins*, even if Congress had established a third-party notice requirement in Section 6303(a), the Commissioner's failure to satisfy that requirement would not bar the United States from bringing a civil suit like this one, which is simply "an action on a debt to impose personal liability"

upon the lender (*Farmers-Peoples Bank v. United States*, 477 F.2d 752, 756 (6th Cir. 1973)).¹⁰

Petitioner does not dispute the correctness of the authorities just cited for the proposition that the government's failure to provide post-assessment notice and demand to a taxpayer is not a bar to a civil suit to collect the taxpayer's debt. Indeed, petitioner seems to acknowledge that the Code prior to 1954 did not require the government to provide notice of assessment to third parties (Pet. Br. 12-13). Petitioner contends, however, that this rule was altered by certain executive-branch reorganizational changes that were made in 1950 and incorporated into the 1954 Code.

Under the 1939 Code, the duty to provide taxpayers with "notice and demand" following an assessment was entrusted to Treasury Department officials called "collectors of internal revenue," who were in charge of administrative tax collection generally; civil actions to collect taxes (then as now) were commenced at the direction of the Attorney General upon request from the Commissioner. Internal Revenue Code of 1939, ch. 2, §§ 3655(a), 3740 and 3940-3978,

¹⁰ The Eleventh Circuit has stated that the government has no inherent common law right to sue to collect Section 3505 liabilities because the debt it thereby seeks to collect "is a creature of statutory, not common law." *United States v. Merchants Nat'l Bank*, 772 F.2d at 1524 n.1; see also *United States v. Messina Builders & Contractors Co.*, slip op. 10-11. This statement completely misses the point. There is no question that liability under Section 3505 is a creature of statute, but so are tax liabilities generally; and there is no doubt that the government has a common law right to sue to collect taxes. It is the government's *right to sue* that is based on common law; it is quite irrelevant whether the *debt* sought to be collected in that suit is created by statute or by common law.

53 Stat. 446, 460, and 480-486. Petitioner views the decisions in *Erie Forge* and *Jenkins* as critically dependent upon this division of labor: the reason that civil suits were there permitted despite the absence of timely notice and demand, petitioner seems to say, is that the courts were reluctant to preclude action by the Attorney General and the Commissioner because of the collector's procedural default. Petitioner asserts (Br. 11-15) that this rationale disappeared in 1954, when Congress centralized in the hands of the Secretary of the Treasury *both* the power of administrative tax collection formerly exercised by tax collectors *and* the power to authorize the Attorney General to institute civil litigation. When Congress codified this reorganization and at the same time enacted a new version of Section 6303(a), petitioner concludes, the effect was to require the Secretary to issue a timely notice and demand to a third party as an absolute prerequisite to the commencement of a civil action against that person.

Petitioner's contention is multiply flawed, as the court of appeals explained in detail below (Pet. App. 13a-17a). First and foremost, the rationale of *Jenkins* and *Erie Forge* was not that the collector's procedural default could not be imputed to other government officials, but that the collector's default affected only the government's ability to collect the tax administratively, rather than eradicating the taxpayer's underlying duty to pay the tax. Since the taxpayer, notwithstanding the absence of notice and demand, continued to have a "legally enforceable liability" to pay the tax, the courts reasoned that the tax could be collected by other means at the government's disposal, such as a civil suit initiated by the Attorney General. See *Jenkins*, 99 F.2d at 828; *Erie*

Forge, 191 F.2d at 631. In short, it was not the identity of the particular government official charged with providing notice and demand, but the nature of the collection method sought to be invoked by the government, that those courts found dispositive.

In any event, the premise of petitioner's contention is that there was a legally significant shift of authority effected by Congress in 1954, and this premise is plainly erroneous. The two organizational changes that petitioner describes—the abolition of the position of tax collector and the vesting of the power to collect taxes administratively in the hands of the Secretary of the Treasury—were effected by Executive Orders in 1950 and 1952. See Reorg. Plan No. 26 of 1950, 15 Fed. Reg. 4935 (1950); Reorg. Plan No. 1 of 1952, 17 Fed. Reg. 2243 (1952). These were changes of form, not substance. Under the 1939 Code, all tax collection activities were under the "general superintendence" of the Commissioner, who in turn was under the direction of the Secretary (§ 3901(a)(1), 53 Stat. 477). Thus, even prior to the 1950-1952 reorganization, the Secretary was ultimately responsible both for administrative tax collection and for recommending the institution of civil litigation, and hence the 1954 Code made no substantive change in this regard. The legislative history makes it clear that the 1954 codification was not intended to change pre-existing notice requirements, since Congress specifically observed that Section 6303(a) contained only "two changes from existing law," neither of which is of any relevance here. See H.R. Rep. 1337, 83d Cong., 2d Sess. A405 (1954); S. Rep. 1622, 83d Cong., 2d Sess. 574 (1954); Pet. App. 15a & n.6. Accordingly, there is no basis for concluding that the 1954 enactment of Section 6303(a)

effected any substantive change with respect to the parties to whom notice must be given or with respect to the consequences of failure to provide such notice. It thus remains the law that the failure to provide Section 6303(a) notice and demand does not bar a civil tax-collection suit. See *Marvel v. United States*, 719 F.2d 1507, 1513-1514 (10th Cir. 1983); *Sherwood v. United States*, 246 F. Supp. 502, 507-508 (E.D. N.Y. 1965).

C. Sending Third Parties A Copy Of The Notice Of Assessment Against The Employer Would Serve No Useful Purpose

Petitioner cannot dispute that furnishing a copy of the notice of assessment to third parties would not serve the overriding purpose of the Section 6303(a) notice provision, namely, to demand immediate payment from the party against whom the assessment is made, thus giving that individual an opportunity to take steps to avoid summary collection procedures. Petitioner argues, however, that third parties will be unfairly prejudiced in other ways if they are not notified of the assessment against the employer. This argument does not withstand analysis.

1. Petitioner asserts (Br. 20-22, 26-27) that, unless third-party lenders receive a copy of the tax bill sent to the employer under Section 6303(a), they may be unaware of the possibility that the government might seek to hold them personally liable under Section 3505, and hence may unwittingly destroy records or take other steps that could prejudice their defense in the event that the government were eventually to bring suit against them. As the court of appeals explained (Pet. App. 17a-19a), the "scienter" standard contained in Section 3505 eliminates any

possibility of prejudice in this regard. That scienter standard ensures that a third party will not be subject to liability under Section 3505 unless it already has in its possession, at the time it advances funds to the employer, all relevant information that would be conveyed to it by a Section 6303(a) notice and demand.

The notice that petitioner seeks would not give third parties any indication of the likelihood that the government might actually bring a Section 3505 action against them. That datum is not within the contemplation of Section 6303(a); indeed, at the time a notice of assessment is mailed to the employer, the IRS typically would have no idea whether it would be likely to bring future suits against third parties. What the Section 6303(a) notice says is that an assessment has been made and that the subject of the assessment must pay the tax due. The relevant information that would be conveyed to a third party receiving a copy of this notice would be that the employer owes taxes (which is apparent from the face of the assessment notice) and perhaps that the government believes the third party to face possible exposure under Section 3505 (which it might deduce from the fact that a copy of the notice was sent to it).

In conveying this information, the Section 6303(a) notice would tell a third-party lender who runs a risk of Section 3505 liability nothing that he does not already know. Section 3505 establishes third-party liability only where the lender is himself paying net wages or where he has "actual notice or knowledge" that the employer will not or does not intend to pay withholding taxes (I.R.C. § 3505(a) and (b)). In either case, the lender is aware that withholding

taxes are not being paid and hence knows that the employer owes taxes. The lender, moreover, is presumed to be aware of the law and hence to know that entering into payroll-financing arrangements causes one to face possible exposure under Section 3505 if withholding taxes are not paid. Thus, any lender that is potentially subject to Section 3505 liability must already have in his possession all relevant knowledge that a Section 6303(a) notice would give him. Because such a lender "must have necessarily been intimately involved in the employer's failure to pay taxes" (*United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d at 1441)), the lender is fully capable of taking whatever steps he deems appropriate to preserve records of the payroll financing operation and otherwise to protect himself against the possibility of a future Section 3505 suit. Receiving a copy of the employer's tax bill would add no relevant facts to the sum of his knowledge and hence the failure to provide him with a copy of that notice would not prejudice him in any way.

Petitioner makes the related point that furnishing an employer's lenders with a copy of the Section 6303(a) notice would "allow the lender to evaluate its ongoing relationship with the borrower" so that it could "take steps to monitor the employer's payment of [withholding] taxes" or even "stop funding the employer completely" (Br. 24-25). Amicus American Bankers Association similarly argues (Br. 11) that the notice of assessment would supply a bank with "knowledge that the borrower is in dire financial straits" so that the bank "would be able to limit its losses on potentially bad loans." But the idea that Section 6303(a) could require the IRS to provide notice and demand to lenders in order to serve these objectives is quite odd. One would have thought that

it is the responsibility of the bank, not of the Internal Revenue Service, to monitor the financial condition of the bank's customers and to evaluate the profitability of a continued debtor-creditor relationship. There is absolutely no reason to suppose that Congress intended to require the IRS to spend public funds to relieve banks of the task of keeping abreast of their borrowers' financial condition.

To the contrary, the legislative history of Section 3505 demonstrates that "Congress envisioned a system in which third parties would take their potential liability under section 3505 into consideration at the time they entered into the transaction exposing them to liability under the statute" (Pet. App. 19a). For example, the committee reports on the 1966 legislation stated that "sureties can protect themselves against any losses attributable to withholding taxes by including this risk of liability in establishing their premiums, and lenders by their including the amounts in their loans and taking adequate security." H.R. Rep. 1884, *supra*, at 22; S. Rep. 1708, *supra*, at 23.¹¹ Congress plainly intended that third parties entering into lending arrangements that might bring them within the purview of Section 3505

¹¹ Petitioner asserts (Br. 28-32) that the reports' statement to this effect related only to Congress's amendment of the Miller Act, 40 U.S.C. 270a(d), that was also a part of the 1966 legislation. Although the heading of the paragraph in which the statement occurs refers to the Miller Act, the statement is prefaced by the phrase "[i]n the cases discussed above," and the context makes it quite clear that this phrase refers to the immediately preceding discussion of Section 3505 liability. The committees apparently were referring both to the Miller Act and to Section 3505 in discussing how third parties could protect themselves against the new liability that was being imposed.

should accept, as an incident of the lending transaction, some responsibility for monitoring the payment of withholding taxes. Indeed, as the Third Circuit observed (Pet. App. 6a), Congress found that lenders who engage in net payroll financing "sit in essentially the same position vis-a-vis control over payroll and access to information as the employer itself." See H.R. Rep. 1884, *supra*, at 20; S. Rep. 1708, *supra*, at 21-22. Thus, Congress cannot have expected that third parties would have any need of the sort of notice provided by Section 6303(a), and Congress cannot have intended to burden the IRS with the duty of communicating with third-party lenders so as to relieve them of their monitoring responsibilities. For these reasons, the court of appeals correctly concluded that furnishing the third-party lender with a copy of the Section 6303(a) notice sent to the employer would merely add a "formalistic requirement for the imposition of section 3505 liability" that would "serve[] no useful purpose" (Pet. App. 18a).

2. Petitioner also contends (Br. 18-22) that a third party is prejudiced by its failure to receive a notice of the assessment against the employer because of the manner in which an assessment affects the statute of limitations applicable to collection suits. Section 6501(a) of the Code generally provides that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed * * * and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period." Section 6502(a)(1) in turn generally provides that, if an assessment is timely made, "such tax may be collected by levy or by a proceeding in court * * * begun * * * within 6

years after the assessment of the tax."¹² Petitioner thus correctly states that an assessment of tax against the employer made on the last day of the three-year limitations period would have the effect of increasing the overall statute of limitations from three years to nine years. Petitioner asserts that it is unfair to provide notice to the employer of this limitations-lengthening event without also providing notice to third parties potentially liable under Section 3505. See Pet. Br. 6, 16-22, 28.

Petitioner's contention is without merit. Although six years after assessment may seem a long time, that is the period that is routinely available to the Commissioner to collect taxes from employers (and from taxpayers generally) where, as will typically be the case, the Commissioner has assessed the taxes in timely fashion. As we have noted above, a third-party lender will run a risk of Section 3505 liability only if it has actual knowledge that the employer's withholding taxes are not being paid. Any prudent lender, moreover, necessarily must assume that the Commissioner will not let the three-year statute of limitations run against the government, but rather will timely assess the unpaid withholding taxes in order to protect the revenue. Lenders who engage in net payroll financing are accordingly on notice to take whatever steps they deem necessary to protect evidence and otherwise preserve their defenses for a period of nine years from the date on which the withholding taxes were due.¹³

¹² Section 6503 provides for the suspension of the running of the statute of limitations in certain specified circumstances.

¹³ If a lender for some reason believes it absolutely essential to be notified that a tax assessment has been made against one of its borrowers, the lender can take various steps to

Equally erroneous is petitioner's assertion (Br. 19) that our interpretation of Section 6303(a), when coupled with the applicable statute-of-limitations rules, "results in less procedural protection to a third party * * * than to the employer." In actuality, third parties are afforded considerably *more* procedural protection than employers by virtue of the fact that the government is not authorized to assess Section 3505 liabilities. Because the IRS in the absence of an assessment cannot resort to summary collection procedures, the lender, unlike the employer, is assured that he will not be deprived of property to satisfy the asserted Section 3505 obligation without a judicial finding of liability. In a Section 3505 action to collect from a lender, moreover, the government bears the burden of proving the elements necessary to establish liability on the lender's part. See, e.g., *United States v. Intercontinental Industries, Inc.*, 635 F.2d 1215, 1219-1220 (6th Cir. 1980); H.R. Rep. 1884, *supra*, at 21; S. Rep. 1708, *supra*, at 23. By contrast, in a collection or refund suit involving the taxpayer against whom the tax is assessed, the assessment is deemed *prima facie* correct and the taxpayer bears the burden of proving it erroneous. See, e.g., *United States v. Janis*, 428 U.S. 433, 440-441 (1976). For these reasons, our interpretation of the statute does not place the lender in a worse

obtain that information. The lender, for example, can draft its lending agreement to require the borrower to notify it upon receipt of any bill for unpaid taxes. If the lender does not believe that it can trust the borrower himself to provide this information, it can require the borrower to execute a power of attorney (IRS Form 2848) or a tax information authorization (IRS Form 2848-D) directing the IRS to mail copies of tax notices and other written communications concerning the borrower to the bank.

position than the employer nor does it otherwise result in unfairness to third parties.¹⁴

3. Amicus First Alabama Bank (Br. 20-25) appears to proffer a further argument on the statute-of-limitations front, one addressed to the proper construction of Section 6502(a) rather than of Section 6303(a). Amicus concedes in this connection (Br. 17 n.9) that the Commissioner's failure to provide Section 6303(a) notice to a third-party lender would not bar a Section 3505 suit against the lender if the suit were brought within the three-year limitations period specified in Section 6501(a). Amicus goes on to argue, however, that Section 6502(a), which permits a civil collection suit to be commenced within six years of assessment, should not be effective against a lender that has not received notice of the assessment. Because the instant suit, on the authority of Section 6502(a), was commenced within six years

¹⁴ It is worth noting that the three-year statute of limitations on assessment of taxes can be extended without the taxpayer's consent or knowledge for various reasons, and that taxpayers cannot be heard to complain of unfairness on this account because their knowledge of the relevant facts puts them on notice to preserve their defenses accordingly. If a taxpayer's return contains a 25% omission from gross income, for example, the three-year statute of limitations on assessment is extended to six years (I.R.C. § 6501(e)(1)(A)), with the Commissioner being allowed another six years to collect taxes properly assessed within that time (I.R.C. § 6502(a)). If the taxpayer fails to file a return, or if any entry on his return is tainted with fraud, his tax may be assessed, or a proceeding in court may be begun without assessment, "at any time" (I.R.C. § 6501(c)(1) and (3)). In all these situations, the taxpayer is presumed to be aware of the exposure to which he has subjected himself by virtue of his conduct, and he accordingly acts at his peril in destroying documents or otherwise failing to preserve relevant evidence.

of the assessments against Pennmount but more than three years after Pennmount's employment tax returns were filed, and because petitioner did not receive a copy of the notice of assessment sent to Pennmount, amicus contends (Br. 20-25) that the three-year statute of limitations of Section 6501(a) bars this action.

We note at the outset that amicus's statute-of-limitations argument is not properly before this Court. The question on which the Court granted review is whether the lender's receipt of a Section 6303(a) notice of assessment is a prerequisite to the government's maintenance of a Section 3505 suit to collect the lender's liability. That question depends upon the proper construction of Section 6303(a) and does not turn on the timing of the government's action. Amicus's statute-of-limitations argument has nothing whatever to do with Section 6303(a), but relates rather to the proper construction of Section 6502(a). A statute-of-limitations defense, moreover, is not available to petitioner here because petitioner did not raise that defense in its answer, as Rule 8(c) of the Federal Rules of Civil Procedure requires, or at any other time in the district court. See Pet. App. 46a-49a. Petitioner's failure to invoke the statute-of-limitations defense in a timely fashion constitutes a waiver that precludes petitioner from raising the defense on appeal. See, e.g., *Perry v. O'Donnell*, 749 F.2d 1346, 1353 (9th Cir. 1984); *Moore v. Tangipahoa Parish School Board*, 594 F.2d 489, 495 (5th Cir. 1979). A fortiori that defense cannot now be raised by an amicus curiae.

In any event, amicus's statute-of-limitations contention is without merit. As amicus recognizes, the Code sets forth no explicit statute of limitations for

Section 3505 suits. In the absence of an explicit statute of limitations, Section 3505 actions might appear at first blush to fall within the general rule that the government is not subject to *any* limitations period unless Congress has specifically provided one. See *Guaranty Trust Co. v. United States*, 304 U.S. 126, 132-133 (1938); *Badaracco v. Commissioner*, 464 U.S. 386, 392 (1984) (statutes of limitations barring the collection of taxes are strictly construed in favor of the government). In *United States v. Updike*, 281 U.S. 489 (1930), however, this Court held that a suit to collect a transferee's third-party liability was governed by the statute of limitations applicable to a suit to collect the taxes from the transferor. The Court explained (*id.* at 493-496) that the congressional purposes underlying both the establishment of the statute of limitations and the imposition of third-party liability are best fulfilled by allowing the government the same period for collection of the third party's liability as applies to the underlying liability of the taxpayer. Application of that principle here would indicate that a suit to collect a lender's Section 3505 liability should be subject to the limitations periods established by the Code for suits against the delinquent employer—that is, six years from the date of the assessment when the assessment is timely made. See I.R.C. §§ 6501(a) and 6502(a)(1); Treas. Reg. § 31.3505-1(d)(1). Accord, e.g., *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d at 1441; *United States v. Associates Commercial Corp.*, 721 F.2d at 1097-1098.

This implicit limitation on the time within which Section 3505 suits can be brought is purely derivative of the explicit limitation placed on suits against

the employer. There is, therefore, no conceivable basis for amicus's contention that, because petitioner did not receive a Section 6303(a) notice, it should be subject to a *shorter* statute of limitations than is the employer. Either Section 3505 collection suits are governed by no limitations period at all, or they are governed derivatively by the limitations period applicable to suits against employers, in which case the latter period and the Section 3505 period must be congruent. It is an impermissible form of bootstrapping to begin with no statute of limitations at all, proceed to find a derivative statute of limitations, and then use that derivative period as a springboard to argue for a still-shorter statute of limitations.¹⁵

Even if there were some basis for amicus's assumption that the Section 6502(a) limitations period is directly applicable to suits against a lender, rather than derivatively applicable through congruence with suits against the employer, there would still be no reason to link the statute of limitations to the receipt or non-receipt of a Section 6303(a) notice. The terms of Section 6502(a) make it quite clear that it is *timely assessment*, not *timely notice* of assessment, that brings the six-year period for collections into

¹⁵ We note incidentally that acceptance of amicus's contention that suits to collect Section 3505 liabilities are subject to a shorter limitations period than suits to collect delinquent withholding taxes from the employer would not necessarily be to the benefit of lenders. If amicus's statute-of-limitations argument were correct, the government in some instances would have little choice but to protect itself by trying to collect first from the lender before exhausting collection efforts with respect to the employer, which is contrary to the Commissioner's present practice. See *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d at 1441; *United States v. Associates Commercial Corp.*, 721 F.2d at 1098.

play. See I.R.C. § 6502(a) (“[w]here the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected * * * within 6 years after the assessment”). Once a timely assessment is made against the employer, in other words, Section 6502(a) gives the government six years to bring a collection suit against the employer, even if the government for some reason failed to give notice of the assessment to him. A fortiori, the government has the same six years to bring suit against a third-party lender irrespective of whether the lender received a copy of that notice.

D. Requiring The Commissioner To Send Section 6303(a) Notice To Lenders As A Prerequisite To A Suit To Collect Their Section 3505 Liabilities Finds No Support In The Legislative History Of Section 3505 And Would Destroy The Practical Utility Of That Provision

1. The legislative history of Section 3505 and the policies underlying it confirm the conclusion derived from an examination of Section 6303(a) alone—namely, that Congress did not intend that the Commissioner be required to furnish third parties with notice and demand under Section 6303(a) as a prerequisite to suit under Section 3505. There is nothing in either the language or history of Section 3505 to suggest that Congress intended a lender's liability to hinge on whether it had received notice of the sort described in Section 6303(a). Indeed, the mechanism that Congress prescribed for collecting the lender's liability clearly suggests the reverse. Congress did not provide the IRS with authority to make an assessment against a third party for Section 3505 liability. Instead, Congress restricted the government to collec-

tion "by appropriate civil proceeding." H.R. Rep. 1884, *supra*, at 66.

This treatment stands in sharp contrast to the mechanism prescribed for collecting certain other third-party liabilities under the Code. Congress has provided, for example, that the liability of certain transferees (I.R.C. § 6901(a)) and of responsible officers (I.R.C. § 6672(a)) "shall be assessed and collected in the same manner as [the] taxes" of the taxpayer itself, thereby empowering the Commissioner to use summary collection procedures following notice and demand. See I.R.C. §§ 6671(a), § 6901(a). Having purposefully established a procedural framework that does not require—or even permit—a separate assessment to be made against the third party (see *United States v. First Nat'l Bank*, 652 F.2d 882, 889 (9th Cir. 1981); *United States v. Dixieline Financial, Inc.*, 594 F.2d at 1313; *United States v. Marine Midland Bank*, 544 F. Supp. 268, 270 (W.D. N.Y. 1982)), Congress is most unlikely to have contemplated extending to third parties the requirement of notice under Section 6303(a). That notice is designed to protect the taxpayer against summary collection procedures and has never been considered a prerequisite to the institution of a civil collection suit (see pages 21-29, *supra*).¹⁶

¹⁶ Petitioner errs in characterizing our position as a contention that Section 3505 creates an "exception" (Pet. Br. 10) to Section 6303(a). On the contrary, as explained in detail above (pages 13-32, *supra*), we submit that Section 6303(a) has never imposed an obligation on the government to send a copy of the taxpayer's notice of assessment to *any* third party, regardless what provision of the Code the third party's liability might rest upon. We note here only that Section 3505 itself imposes no such obligation and provides no reason to give Section 6303(a) a different construction.

2. The fact that Congress did not intend to make Section 6303(a) notice to lenders a prerequisite to a civil suit under Section 3505 is confirmed by examining the practical effect that such a requirement would have. The court of appeals below correctly concluded (apparently without intending an oxymoron) that a notice requirement would render Section 3505 "a substantial nullity" (Pet. App. 21a).

When the Commissioner makes an assessment of unpaid withholding taxes, he ordinarily will have no way of knowing whether the delinquent employer has borrowed money from a third party under circumstances that might render the latter liable under Section 3505. There is no indication on the face of the employment tax return who the employer's creditors might be, much less any indication whether such creditors might themselves have paid net wages (I.R.C. § 3505(a)) or have "actual * * * knowledge" (I.R.C. § 3505(b)) of the employer's withholding tax delinquency.¹⁷

¹⁷ The suggestion of amici American Bankers Association (Br. 12) and First Alabama Bank (Br. 16 n.8) that the IRS could solve these practical problems by modifying the employment tax return to require the employer to identify its creditors is wholly unrealistic. To begin with, the vast bulk of lending arrangements expose the lender to no conceivable risk of liability under Section 3505. Obtaining a list of *all* lenders and then giving them notice of the assessment against the employer is not only grossly overinclusive, but could result in severe financial burdens on employers by impairing their access to the credit markets. Nor would it be feasible for the IRS to require the employer to disclose the names of only those lenders who might be liable under Section 3505. The determination that a lender is liable under Section 3505 may present complex factual and legal issues, issues that the employer is obviously in no position to resolve. Moreover, an employer who is not paying his employment taxes may well

Moreover, the Commissioner cannot reasonably be expected, at the time he makes the assessment against the employer, affirmatively to undertake to identify the lenders who may have potential liability for the unpaid withholding taxes. The IRS during 1984 received about 19 million quarterly employment tax returns, almost six million of which were accompanied by only partial payment or by no payment at all.¹⁸ In order to protect the revenue, the Commissioner typically assesses such delinquent taxes against the employer within a month or two after receiving the return. As the court of appeals observed (Pet. App. 20a), it would obviously "impose a prohibitory investigative burden on the government" to require the Commissioner, within 60 days of making those six million assessments, to identify and notify all lenders who might be personally liable for the taxes thus assessed.

Even if such investigations were realistically possible, they would entail a tremendous waste of resources. Like any creditor, the Commissioner ordinarily tries to collect delinquent withholding taxes first from the employer itself by sending the employer

be in desperate financial shape, and he cannot be depended upon to disclose the identity of the lenders who are supplying him with sorely needed funds. Finally, if failure to provide Section 6303(a) notice were a bar to collection of Section 3505 liability, keying that notice to information contained in employer returns would enable the employer to insulate his lenders from liability simply by omitting their names from his tax returns. In short, amici's suggestion, which resembles a suggestion recently advanced by the Eighth Circuit (*United States v. Messina Builders & Contractors Co.*, slip op. 11), is completely unsatisfactory.

¹⁸ These statistics have been provided to us by the IRS and are based on information in its files.

a series of bills (i.e., notice and demand under Section 6303(a)) for the unpaid taxes. See M. Saltzman, *supra*, ¶ 14.03, at 14-11 *et seq.* If collection efforts against the employer fail,¹⁹ it is the Commissioner's usual practice to try to collect under Section 6672 from the employer's responsible persons. Only after those avenues have been investigated does the Commissioner normally explore the possibility of collection from lenders.²⁰ Indeed, the IRS estimates that Section 3505 comes into play in about only one case for every 5,000 withholding-tax delinquencies. Because lenders in the vast majority of cases will never be called upon to pay the delinquent taxes, it would be exceedingly inefficient and wasteful for the IRS to go to the expense of identifying and notifying them at the very outset of the collection process—a step that would needlessly embarrass employers and convey no useful information to lenders in any event.

Petitioner's suggestions for avoiding the formidable practical obstacles to giving Section 6303(a) notice to lenders are wholly unsatisfactory. The idea (Pet. Br. 23) that the IRS should delay making an assessment against the employer-taxpayer for up to three years, instead of making the assessment within a month or two of receiving the employer's return as

¹⁹ In most cases, collection is achieved without the need to take any steps other than sending notices to the employer. In 1984, for example, only about 1.1 million of the 6 million employment tax returns involving delinquencies gave rise to the issuance of "taxpayer delinquency accounts," which are issued after attempts to collect by sending notices to the taxpayer fail.

²⁰ There is nothing in the Code, however, that requires the Commissioner to try to collect the taxes from the employer and from the responsible persons under Section 6672 before pursuing lenders under Section 3505. Cf. note 15, *supra*.

is the Commissioner's current practice, would constitute a rather clear breach of the Commissioner's duty to protect the public fisc. As the court of appeals correctly recognized (Pet. App. 21a), such a delay in making the assessment would "seriously jeopardize the government's interest in collecting the taxes from the employer" because it would "enable other creditors to obtain prior liens against the employer's property."²¹

Equally flawed is the alternative suggestion of petitioner (Br. 25) and of amicus American Bankers Association (Br. 13) that the IRS should make its usual prompt assessment against the employer (without notice to lenders) and then make a "supplemental assessment" against the employer (with notice to lenders) under Section 6204(a) within three years after the return is filed. See also *United States v. Messina Buildings & Contractors Co.*, slip op. 12, where the same suggestion is advanced. Petitioner and amicus apparently offer this suggestion on the theory that, in the interim between the initial and supplemental assessments, the IRS would have enough time to undertake an investigation to learn the identities of third parties potentially subject to Section 3505 liability. This suggestion, of course, is inconsistent with petitioner's basic argument that Section 6303 (a) demands notice to third parties of an assessment against the employer within 60 days of making that assessment. Moreover, it is doubtful that petitioner's suggestion could be effectuated under existing law.

²¹ Even if the amount of the withholding taxes were eventually recovered from the lender under Section 3505, the Treasury would still lose funds under petitioner's proposed procedure because delinquencies in the employer's portion of the social security tax can be collected only from the employer.

Section 6204(a) allows the Secretary to make a supplemental assessment only when "it is ascertained that any assessment is imperfect or incomplete in any material respect." This provision would not appear to be applicable where the only defect alleged is that a copy of the notice of assessment was not sent to a third party.

In sum, the practical effect of requiring the sort of notice sought by petitioner would be to eviscerate Section 3505. It is inconceivable that Congress, in enacting this provision to eradicate the practice of net payroll financing, would at the same time have incorporated a notice requirement that would so substantially weaken the statute as to ensure that the practice would continue unabated. The conclusion is inescapable that receipt of Section 6303(a) notice to an employer is not a prerequisite to a civil suit against a third party lender to collect a Section 3505 liability.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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CLERK

In The
Supreme Court of the United States
October Term, 1986

— 0 —
JERSEY SHORE STATE BANK,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

— 0 —
**ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE THIRD CIRCUIT**

— 0 —
REPLY BRIEF FOR PETITIONER

— 0 —
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ARGUMENT

I. NOTICE IS REQUIRED TO BE GIVEN TO EACH PERSON LIABLE FOR THE TAX PURSUANT TO SECTION 6303(a).

A. The mandate of Section 6303(a) must be followed.

The breadth of the Government's argument with regard to the non-applicability of Section 6303(a) is seen in the manner it attempts to eliminate the notice requirement of Section 6303(a) from the Code in total.¹ The Government argues that not only does it not have an obligation to provide notice of an assessment to a third party lender, but that it has no liability for providing *any* notice of assessment even to the employer in order to have the benefit of the extended statute of limitations to collect the tax. The Government notes: "Once a timely assessment is made against the employer, in other words, Section 6502(a) gives the government six years to bring a collection suit against the employer, even if the government for some reason failed to give notice of the assessment to him. A fortiori, the government has the same six years to bring suit against a third-party lender irrespective of whether the lender received a copy of that notice." (Res. Br. 43).

The position of the Government appears to be that there is no notice requirement in the Code to anyone in order for the statute of limitations to be extended for an additional six years once assessment has been made against the employer within three years after the tax return has been filed. Such an interpretation, directly contradicts the plain language of Section 6303(a) with regard to notice.

¹Statutory references are to sections of the Internal Revenue Code of 1954 (26 U.S.C.) as amended, and as applicable to the time periods involved in this case, unless otherwise indicated.

The Government simply cannot have it both ways. The Government cannot argue that the Code should be strictly construed with regard to the assessment procedure and the extension of the statute of limitations for an additional six years under Section 6502 and then argue that Section 6303(a) with its equally precise language be ignored with regard to providing notice of the assessment to "each person liable for the tax."

B. The statute of limitations issue is secondary to the requirement of notice.

The issue with regard to the statute of limitations under Section 6501 and 6502 is secondary to the notice requirement of Section 6303(a). It is only pursuant to Section 6303(a) that notice is required to be given by the Government to "each person liable for the tax." If one accepts the argument of the Government that no notice is required to be given to any person liable for the tax, whether it be the employer, or the lender, then the statute of limitations question does not arise. Under this theory suit may be commenced within three years of when the tax return is filed or alternately if an assessment is made during such period the statute of limitations is extended for another six years under Section 6502. (See Res. Br. at 42-43). The net effect of this position advocated by the Government, is to eliminate Section 6303(a) from the Code.

If one accepts, however, the argument adopted by the Seventh, Eighth and Eleventh Circuits that the notice provision of Section 6303(a) must be complied with when the Government seeks to impose derivative liability on a lender under Section 3505, then the failure of the Government to provide such notice within 60 days after assessment con-

stitutes a defect in compliance with the statutory requirements imposed for collection of the tax from lenders.

As noted by the district court in the instant case:

"The IRS takes the position that requiring the IRS to notify potentially liable third parties will undermine the purpose of § 3503(b) [sic] under which Congress intended to create an additional source for the recovery of unpaid withholding taxes. But as pointed out by the Bank, 26 U.S.C. § 6501(a) provides that the Government has three years from the time that a tax return is filed to impose an assessment." (Pet. App. 34a-35a).

Once the assessment has been made then notice must be provided. The key element, however, as was addressed in the district court opinion is the making of the assessment, which when done within the three year period of Section 6501, triggers the notice provision of Section 6303(a) and also extends the statute of limitations for another six years pursuant to Section 6502.

Without receiving any notice of assessment, the lender is a person liable for the tax under Section 3505 but receives less procedural protection than the employer who is primarily liable for the tax and who does receive notice of the assessment. The basic question is who is more in need of notice; the employer who fails to pay the tax and receives notice within 60 days of assessment, or the lender who is held derivatively liable for the tax up to nine years later and who presently receives no notice from the Government until suit is filed against him for the taxes?²

²The Government suggests that the lender in all loans could have employer borrowers execute a power of attorney (IRS

II. NOTICE TO A LENDER SERVES A USEFUL PURPOSE.

A. Notice of a tax assessment is relevant to a third party lender.

The Government argues that notice of the assessment to the lender is irrelevant and would provide no useful purpose. (Res. Br. 32-43). This contention has been rebutted both by Judge Weis in his dissenting opinion in the Third Circuit in the instant case (Pet. App. 23a) and more recently by the Eighth Circuit in *United States v. Messina Builders and Contractors Co.*, 801 F.2d 1029, No. 85-2505 (8th Cir. Sept. 23, 1986).³

The Eighth Circuit in disagreeing with the majority opinion of the Third Circuit in the instant case noted:

“A party receiving 6303(a) notice learns two things: that the government is seeking payment of delinquent taxes, and the amount of those delinquent taxes. The third party presumably will know that the

(Continued from previous page)

Form 2848) or a tax information form (IRS Form 2848-D) which would direct the IRS to mail copies of all tax notices to the lender. (Res. Br. 37-38 n. 13). Such an argument would shift the statutory obligation of the Government under § 6303(a) to the lender. In addition, if one accepts the Government's contention that § 3505 liability arises in only one out of 5,000 withholding tax delinquency cases (Res. Br. 17), such a suggestion would hardly appear to aid the Government in the orderly administration of the tax code by requiring that copies of all tax notices of all employer borrowers be sent to lenders regardless of whether a delinquency existed that involved a § 3505 liability.

³The Government has cited this case in its brief as a slip opinion. The full text of this recent authority which has not been previously filed with the Court is attached hereto in the appendix to this brief.

employer is the source of the liability and thus has the opportunity to contact the employer and attempt to correct the situation, or at least, to stop advancing sums to the employer and thus lessen the total amount of liability. The notice provided to a third party, notifying him that the employer is delinquent and that the IRS is demanding payment for the amount the employer owes, thus serves an important function. To minimize the possibility that a third party will misinterpret the notice as a demand that the third party immediately pay a larger sum than he may owe, it would not be overly burdensome to the IRS to amend the notice to include explanatory information relating to the legal status of the third-party lender.” (App. 9a).

The Government argues that the liability of the lender for the employer's taxes is only speculative in nature and “because the lender's liability in practical terms is highly contingent at the time the Section 6303(a) notice is mailed to the employer, it is difficult to describe the lender at that moment as a ‘person liable’ for the unpaid tax.” (Res. Br. 17).

This argument completely obviates the legal consideration, however, whether the lender is or is not liable for the tax. The legal liability of the lender for the tax is fixed at the moment that funds are supplied to the employer in a manner which violates the statutory proscriptions of Section 3505. It is only the proof of such liability for the tax which remains to be shown by the Government. If the lender is liable for the tax, a conclusion which the Government plainly believes by virtue of having instituted the suit to collect the derivative tax, then the issue of the lender's liability “in practical terms” or as a speculative consideration evaporates and notice is required to be given to the lender under the provisions of Section 6303(a).

B. Lenders are prejudiced by receiving no notice of the assessment.

The Government attempts to counter the petitioner's argument that the lender is not prejudiced by not receiving notice of the assessment and facing the risk of suit nine years after the employer's tax return was filed because "a third-party lender will run a risk of Section 3505 liability only if it has actual knowledge that the employer's withholding taxes are not being paid . . . Lenders who engage in net payroll financing are accordingly on notice to take whatever steps they deem necessary to protect evidence and otherwise preserve their defenses for a period of nine years from the date on which the withholding taxes were due." (Res. Br. 37).

This is precisely the problem. Lenders are supposedly "on notice" but yet they receive no notice. The above argument also fails to take into account the definition of the term "actual notice or knowledge" contained in the Internal Revenue Code. As the Eighth Circuit in *Messina*, *supra*, noted:

"The definition of 'actual' knowledge in section 3505 is so broad, however, as to create liability even with no actual knowledge. The Ninth Circuit in *Hunter* admitted that 'we agree that this statutory scheme does not wholly negate the possibility of prejudice to the lender * * *.' *Hunter* at 1441. Section 3505(b) requires the lender to have 'actual notice or knowledge (within the meaning of section 6323(i)(1))' that the employer did not intend to or could not pay the taxes. Code section 6323(i)(1) provides that an organization is deemed to have actual notice of a fact that would have been brought to its attention had it exercised due diligence. Thus, a lender who has no actual knowledge of the employer's failure to pay the

tax but who has failed to exercise due diligence is nonetheless subject to section 3505(b) liability." (App. 10a).

A lender can therefore be held liable for the tax with actual notice or knowledge being imputed to him as defined in the Code but which in reality can mean a failure to exercise due diligence. In such a context it is clear that a lender is prejudiced in a practical as well as a legal manner by receiving no notice of the assessment as required by Section 6303(a).

C. Responsible officers are entitled to notice under Section 6672 of the Code.

The Government in its responsive brief notes that "responsible officers" who are liable for taxes under Section 6672 do not receive notice of the assessment against the employer under Section 6303(a). (Res. Br. 18 n.4).

Such an argument, however, ignores the fact that responsible officers under Section 6672(b) are required to be given a 30 day notice of the tax which the Government is seeking to collect from them before any levy or proceeding in court can be instituted by the Government.⁴

In addition, the responsible officers of a corporation as a practical matter will have previously been aware of the fact that the employer has filed a tax return which

⁴IRS Form 2751 notifies the responsible officer of the "Proposed Assessment of 100 Percent Penalty" under Section 6672 and is accompanied by a collection letter notifying the individual of the proposed assessment. cf: M. Saltzman, *IRS Practice and Procedure* § 17.10 at 17.44 et seq. (1981); R. Schriebman, *IRS Tax Collection Procedures* § 731 at 226-227; § 786-88 at 243-246 (1985).

indicates the amount of the tax due but which does not remit to the Government funds for payment of such taxes. Therefore, responsible officers under Section 6672 will have actual notice of the employer's failure to pay the tax and will also receive statutory notice under Section 6672 of the intention of the Government to seek collection of the taxes from them.

In addition, the notice requirement of Section 6303(a) states that the notice requirement is only applicable: "Where it is not otherwise provided by this title . . ." Under Section 6672 a separate notice of taxes sought to be collected is provided to the responsible officers and therefore the notice requirement of Section 6303(a) does not come into effect.

III. NO COMMON LAW RIGHT FOR COLLECTION OF THE TAX EXISTS THAT IS INDEPENDENT OF THE STATUTORY REQUIREMENTS OF THE CODE.

The Government argues that it has a common law right to institute suit to collect the tax that is independent of the statute. The position of the Government fundamentally misconceives the relationship between the tax statute and the right to sue to collect the tax. As the Government admits: "There is no question that liability under Section 3505 is a creature of statute, but so are tax liabilities generally; and there is no doubt that the Government has a common law right to sue to collect taxes." (Res. Br. 29 n.10). The Eighth Circuit in its opinion in *Messina, supra*, addressed this argument in detail citing from the decision of the Eleventh Circuit in *United States v. Merchants National Bank of Mobile*, 772 F.2d 1522 (11th Cir. 1985) (*per*

curiam); petition for *cert. pending*, No. 85-1480. The Eighth Circuit noted:

"The government argues that it has a common-law right, existing independently of any statute, to sue on a debt. The government points out that no statute makes a suit by the United States to collect tax dependent on notice and demand, and thus a failure to assess or give notice will not bar a suit. This argument, however, ignores the fact that section 3505 creates a derivative liability, nonexistent at common law. As the Eleventh Circuit stated in *Merchants*:

"The United States also argues that even if § 6303(a) requires notice to third-parties such as MNB, the failure to give notice does not preclude suit to collect on MNB's alleged § 3505 liability. The United States contends that it has an inherent common law right to sue to collect debts which is entirely independent of the assessment process. Appellant, however, ignores the fact that third-party derivative liability of the sort set forth in § 3505 is a creature of statutory, not common, law. This argument is therefore untenable."

Merchants at 1524 n.1.

We thus reject the government's attempt to recharacterize the third-party liability imposed by section 3505." (App. 11a).

In order to sue to collect the tax which is being imposed derivatively on the lender under Section 3505, the Government must of necessity comply with all statutory requirements of the Code for imposition of the tax, including the notice requirement of Section 6303(a).⁵

⁵If the Government were to prevail in its argument that it had a common law right to sue for the tax independent of any requirements of the Code, then the Government could likewise ignore Section 6501 requiring it to bring suit within three years or file an assessment to extend the period to recover the tax by levy or proceeding in court for another six years under Section 6502.

CONCLUSION

For the foregoing reasons, the petitioner, Jersey Shore State Bank, respectfully prays that this Court reverse the judgment of the court of appeals and order reinstatement of the judgment of the district court.

Respectfully submitted,

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November 12, 1986

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 85-2505

United States of America *

Appellant, *

v. *

Messina Builders and
Contractors Co., and
Mike Messina, *

Appellees. *

* Appeal from the United
States District Court for
the Western District of
Missouri.

Submitted: June 11, 1986

Filed: September 23, 1986

Before JOHN R. GIBSON, MAGILL, and FAIRCHILD,*
Circuit Judges.

MAGILL, Circuit Judge.

This appeal concerns whether the Internal Revenue Service ("IRS") must notify a third party, who provides the wages an employer pays its employees, of the employer's tax deficiency on those wages. For the reasons discussed below, we affirm the judgment of the district court¹ that notice is required to a third-party provider.

(p. 2) I. PERTINENT STATUTES.

At the heart of this dispute are Internal Revenue Code ("Code") sections 3505 and 6303, 26 U.S.C. §§ 3505, 6303.

*HON. THOMAS E. FAIRCHILD, United States Senior Circuit Judge for the Seventh Circuit, sitting by designation.

¹The Honorable D. Brook Bartlett, United States District Judge for the Western District of Missouri.

Section 3505(a) creates tax liability in a third party who pays wages directly to an employer's employees, and section 3505(b) creates tax liability in a third party who, knowing that the employer will not or cannot pay its employees' withholding taxes, nonetheless supplies wages to the employer.²

(p. 3) Section 6303 provides in pertinent part:

²Section 3505 provides in pertinent part:

§ 3505. Liability of third parties paying or providing for wages.

(a) Direct payment by third parties

[I]f a lender, surety, or other person, who is not an employer * * * with respect to an employee or group of employees, pays wages directly to such an employee or group of employees, * * * such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes * * * required to be deducted and withheld from such wages by such employer.

(b) Personal liability where funds are supplied

If a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment * * * of tax required * * * to be deducted and withheld * * *, such lender, surety, or other person shall be liable in his own person and estate to the United States * * *. However, the liability of such lender, surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied * * *.

(c) Effect of payment

Any amounts paid to the United States pursuant to this section shall be credited against the liability of the employer.

§ 6303. Notice and demand for tax

(a) General rule

Where it is not otherwise provided by this title, the Secretary shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof.

Two other Code sections are integral to this issue. 26 U.S.C. § 6501, entitled "Limitations on assessment and collection," provides in pertinent part that: "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed * * * and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period." 26 U.S.C. § 6502 provides in pertinent part:

§ 6502. Collection after assessment

(a) Length of period

Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun—

(1) within 6 years after the assessment of the tax * * *.

Thus, making an assessment within the three-year time limit prescribed by section 6501 permits collection efforts up to six years after assessment, or a total of nine years after a return is filed.

II. BACKGROUND.

In December of 1981, Messina Builders and Contractors (p. 4) Company, Inc. ("Messina"), a Missouri corporation engaged in general contracting and remodeling,

entered into two subcontracts for the City of Kansas City, Missouri, with Dummie, Inc. ("Dummie"), a Missouri corporation owned by Charles E. Edwards ("Edwards"). Edwards also owned C&C Plumbing Company, Inc. ("C&C"), whose employees performed the work on the two subcontracts. After six months Dummie was financially unable to continue, and Messina finished the project. Edwards filed tax returns and amended returns with the IRS for the second and third quarters of 1982, reporting taxes due on the wages paid to C&C employees for their work on the project. No payment was made, however, with any of these returns.

The IRS made assessments and gave C&C notice and demand for payment of the taxes, plus interest and penalties for a total of \$13,235.22. Then, more than sixty days after having made assessments against C&C, the IRS demanded payment from Messina pursuant to section 3505(b), alleging that Messina had supplied funds to Dummie to pay the C&C employees performing the work. Messina denied the allegations and defended on the ground, inter alia, that the time limit of section 6303 had expired. The district court granted summary judgment for Messina and the United States brought this appeal.

III. SCOPE AND STANDARD OF REVIEW.

The parties agreed in the district court that the sole issue for determination was whether the notice provision of section 6303 is a condition to the liability imposed by section 3505(b). Accordingly, we limit our review to that issue. *Rogers v. Masem*, 788 F.2d 1288, 1292 (8th Cir. 1986).

When reviewing an appeal from a district court's grant of a motion for summary judgment, we apply the same standard as the district court was to have applied. *Elbe v.*

Yankton Indep. (p. 5) School Dist. No. 1, 714 F.2d 848, 850 (8th Cir. 1983). We must view all facts and reasonable inferences drawn from the facts in the light most favorable to the party opposing the motion. *Kresse v. Home Ins. Co.*, 765 F.2d 753, 754 (8th Cir. 1985). Summary judgment may be granted only when there is no genuine issue of material fact and the moving party has proved he is entitled to judgment as a matter of law. *Id.* See also Fed. R. Civ. P. 56(c).

IV. DISCUSSION.

This issue has left the courts of appeals in disarray. The Seventh and Eleventh Circuits hold that section 6303 requires notice to a third-party lender,³ *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983); *United States v. Merchants Nat. Bank of Mobile*, 772 F.2d 1522 (11th Cir. 1985),⁴ while the Third and Ninth Circuits hold that notice to a third-party lender is not required. *United States v. Jersey Shore State Bank*, 781 F.2d 974 (3d Cir. 1986), cert. granted, 54 U.S.L.W. 3793 (U.S. June 2, 1986) (No. 85-1736); *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d 1436 (9th Cir. 1986). We believe the Seventh and Eleventh Circuits espouse the better view, requiring notice to a third party.

The government advances substantially the same arguments set out in *Associates*, *Merchants*, *Jersey Shore*, and *Hunter*; in short, (1) that notice protection is only neces-

³Our use of the word "lender" is not intended to limit the applicability only to lenders. We use it instead as a convenient way to refer to all persons who may be subject to section 3505 liability.

⁴The Eleventh Circuit in *Merchants*, in a short per curiam opinion, simply "agree[d] with the Seventh Circuit's reading of the applicable statutory provisions * * *." *Merchants* at 1524.

sary for tax collection by levy, not by suit; (2) that notice to a third party is in- (p. 6) appropriate and unnecessary; (3) that the government's right to sue for taxes, without notice and demand, is a common-law right independent of statute; (4) that requiring notice to a third party would greatly hinder the tax collection efforts of the IRS; and (5) that any prior changes in the Code did not expand the notice requirement.

Although many aspects of these arguments are persuasive and the equities are far from one-sided, these considerations must bow to the plain language and meaning of the statute, which specifies that "each person liable" for the tax must receive notice. As Judge Weis aptly stated, dissenting in *Jersey Shore*:

The IRS wishes us to redraft that section so that it requires notice only to those individuals against whom taxes have been assessed. The reasons offered for this revision have some logic and would possibly ease administrative burdens on the government, but the arguments are directed to the wrong forum. They should be presented to Congress, not the courts.

Jersey Shore at 983-84 (Weis, J., dissenting).

A. Plain language.

In *American Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982), the Supreme Court stated:

As in all cases involving statutory construction, "our starting point must be the language employed by Congress," *Reiter v. Sonotone Corp.*, 442 U.S. 330, 337 (1979), and we assume "that the legislative purpose is expressed by the ordinary meaning of the words used." *Richards v. United States*, 369 U.S. 1, 9 (1962). Thus "[a]bsent a clearly expressed legislative intention to the contrary, that language must ordinarily be re-

garded as conclusive." *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

The language in the statutes under discussion is abundantly clear. Section 3505 establishes that third parties may be liable (p. 7) for an employer's tax. The title of section 3505 reads: "*Liability of third parties paying or providing for wages*" (emphasis added). Both subsections (a) and (b) provide that "such [third-party] lender, surety, or other person *shall be liable* * * * to the United States" for the delinquent taxes (emphasis added). The conclusion appears inescapable that section 6303(a), when it speaks of "each person liable," includes the third-party lender. Like the Seventh Circuit in *Associates*, we conclude that Congress in section 3505 "established a nexus between the taxpayer's obligation and the lender's liability," *Associates* at 1097, and that the same limitations period should apply to both, for the requirement of notice to "each person liable for the unpaid tax" is clear in requiring notice to the third party.

B. Administrative proceeding v. lawsuit.

The government argues that notice is only necessary for administrative collections such as levy or distraint, where the government may proceed summarily, and that where the government must proceed by lawsuit, as with section 3505, service of the complaint provides adequate notice. The *Jersey Shore* court also distinguished between tax collection by administrative process and tax collection by lawsuit, pointing out that "the predecessor statute to section 6303(a) explicitly applied only to the collection efforts of the tax Collector, who by statute was authorized to collect taxes solely by administrative means, such as levying

on the taxpayer's property. I.R.C. § 3655 (1952).” *Jersey Shore* at 979.

We disagree. The plain language of section 6303(a) does not support the position set forth in *Jersey Shore* and argued by the government. The *Associates* court stated that:

Section 6303(a) itself does not indicate that the right to notice is dependent on which tax collection option the government uses. * * * Section 6303(a) requires (p. 8) notice of the assessment of unpaid taxes in order to protect the person liable for paying the taxes, * * * and this rationale applies regardless of which collection mechanism is used.

Associates at 1100.

Our interpretation finds support in the mechanics of sections 3505 and 6303. Without notice, a third party could wait up to nine years after the employer files a return to learn of his potential liability. As Judge Will stated in the district court in *Associates*, “[t]he possibility of prejudice is obvious. Records and personnel may no longer be available. The opportunity to mitigate by making voluntary payments is lost. Interest mounts. The possibility of recovering from the borrower-employer diminishes. All of these would be obviated by notice.” *Associates*, 548 F.Supp. 171, 174 (N.D. Ill. 1982).

C. Applicability to third-party lender.

The government, following the reasoning of the Third Circuit in *Jersey Shore*, argues that section 6303(a) was not intended to apply to a third-party lender. The *Jersey Shore* court noted that “a section 6303(a) notice consists of two discrete elements: (i) notice of the amount that has

been assessed and (ii) a *demand* that the individual receiving the notice *presently* satisfy that assessment.” *Jersey Shore* at 978 (emphasis in original). The *Jersey Shore* court noted that the amounts of the employer's and the lender's tax liability will probably differ because the lender is not liable for the employer's portion of payroll taxes and because section 3505(b) limits lender liability to twenty-five percent of its loan. The court reasoned that notifying the third party of the employer's liability would be misleading and inappropriate. The court also noted that section 6303(a) does *not* demand payment from the third-party lender; rather, the government seeks at that time to collect only from the employer. The court was persuaded by these factors that Congress (p. 9) did not intend third-party lenders to receive notice of assessment.

We disagree, finding an alternative interpretation equally plausible. A party receiving 6303(a) notice learns two things: that the government is seeking payment of delinquent taxes, and the amount of those delinquent taxes. The third party presumably will know that the employer is the source of the liability and thus has the opportunity to contact the employer and attempt to correct the situation, or at least, to stop advancing sums to the employer and thus lessen the total amount of liability. The notice provided to a third party, notifying him that the employer is delinquent and that the IRS is demanding payment for the amount the employer owes, thus serves an important function. To minimize the possibility that a third party will misinterpret the notice as a demand that the third party immediately pay a larger sum than he may owe, it would not be overly burdensome for the IRS to amend the notice to include explanatory information relating to the legal status of the third-party lender.

D. Requirement of knowledge by third party.

The government next argues that because section 3505 requires a third party to have knowledge of the employer's financial state, the possibility for prejudice to the third party is nonexistent and additional notice would "serve no useful purpose." As the *Jersey Shore* court stated, "section 3505 liability only arises if the third party * * * is * * * actually or constructively aware of its *potential* liability for the taxes required to be deducted and withheld." *Jersey Shore* at 982 (emphasis in original).

The definition of "actual" knowledge in section 3505 is so broad, however, as to create liability even with no actual knowledge. The Ninth Circuit in *Hunter* admitted that "we agree that (p. 10) this statutory scheme does not wholly negate the possibility of prejudice to the lender * * *." *Hunter* at 1441. Section 3505(b) requires the lender to have "actual notice or knowledge (within the meaning of section 6323(i)(1))" that the employer did not intend to or could not pay the taxes. Code section 6323(i)(1) provides that an organization is deemed to have actual notice of a fact that would have been brought to its attention had it exercised due diligence. Thus, a lender who has no actual knowledge of the employer's failure to pay the tax but who has failed to exercise due diligence is nonetheless subject to section 3505(b) liability.

Alternatively, as Judge Will pointed out in the district court in *Associates*, "the mere fact that a lender is aware * * * that the government has filed a claim for unpaid withholding taxes is hardly notice to the lender that the government will seek to hold it liable under section 3505(b) * * *." *Associates*, 548 F.Supp. at 174-75. Notice is therefore necessary to lenders regardless of their actual knowledge of the employer's liability. As Messina points out, even assuming the lender knows of his potential liability

under section 3505(b), the government still must provide notice upon assessment for the same reason that the government, upon making an assessment against a taxpayer who has filed a return but who has failed to pay in full, must still give notice to the taxpayer even though he is aware of his tax liability.

E. Government's common-law right to sue.

The government argues that it has a common-law right, existing independently of any statute, to sue on a debt. The government points out that no statute makes a suit by the United States to collect tax dependent on notice and demand, and thus a failure to assess or give notice will not bar a suit. This argument, however, ignores the fact that section 3505 creates a (p. 11) derivative liability, nonexistent at common law. As the Eleventh Circuit stated in *Merchants*:

The United States also argues that even if § 6303(a) requires notice to third-parties such as MNB, the failure to give notice does not preclude suit to collect on MNB's alleged § 3505 liability. The United States contends that it has an inherent common law right to sue to collect debts which is entirely independent of the assessment process. Appellant, however, ignores the fact that third-party derivative liability of the sort set forth in § 3505 is a creature of statutory, not common, law. This argument is therefore untenable.

Merchants at 1524 n.1.

We thus reject the government's attempt to recharacterize the third-party liability imposed by section 3505.

F. Administrative burden.

The government next argues that the increased administrative burden imposed by third-party notice "would of-

fectively render section 3505 a dead letter." The *Associates* court called a similar claim "highly speculative and unsupported by any convincing statistics." *Associates* at 1099. The *Jersey Shore* court disagreed, stating that "in light of the manner such taxes are collected, available statistics and common sense both dictate that such a requirement would impose a prohibitory investigative burden on the government." *Jersey Shore* at 983. Although we recognize that a third-party notice requirement imposes an increased burden upon the IRS, this burden is not an unreasonable one. The IRS could modify its forms, pursuant to Code section 6011(a), to obtain information from the employer identifying any third-party lenders. Lenders listed on these returns could then be given a "protective" notice and demand, notifying them of their potential liability and demanding payment only if their loans violate section 3505. The IRS could also make separate (p. 12) assessments of the lenders' section 3505(b) liability.⁵ Because section 6501 allows a separate assessment to be made within three years from the time the employer's return is filed, this would give the IRS reasonable time to proceed.

⁵We disagree with the Ninth Circuit's holding in *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311, 1312 (9th Cir. 1979), that because the assessment against the employer represents "the amount of the only sum in question," thus "independent assessment [against the third party] would accomplish nothing." As the Third Circuit acknowledged in *Jersey Shore*, the amount of the lender's liability will probably differ from the amount of the employer's liability, because of "both the differences between the taxes for which the employer and third party are liable and the limitations on liability contained within section 3505 itself." *Jersey Shore* at 978. Thus an independent assessment of the lender's liability has substantial informative value, and would allow the IRS to give the lender timely notice of that assessment and thereby maintain a section 3505 (b) action.

The IRS could, alternatively, make a supplemental assessment pursuant to Code section 6204(a), which permits a supplemental assessment "whenever it is ascertained that any assessment is imperfect or incomplete in any material respect."

By using either a separate or a supplemental assessment, the IRS could first quickly assess the employer, thereby avoiding a delay that "would seriously jeopardize the government's interest in collecting the taxes from the employer, because such a practice would enable other creditors to obtain prior liens against the employer's property." *Jersey Shore* at 983. The IRS would then have three years in which to investigate the employer and file a separate or supplemental assessment, then provide notice to the third party. This result would give the IRS time to conduct a full investigation while shortening the time the third party is unaware of its potential liability from nine years to a more equitable three years.

(p. 13) G. Legislative history.

We next address the government's interpretation of the legislative history. The government points out that although the predecessor to section 6303(a) was revised to become section 6303(a) in the 1954 Code, the Committee Reports stated that section 6303 "contains two changes from existing law," neither of which is pertinent to the issue of notice to a third party. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A405-06, *reprinted in* 1954 U.S. Code Cong. & Ad. News 4017, 4553; S. Rep. No. 1622, 83d Cong., 2d Sess. 574, *reprinted in* 1954 U.S. Code Cong. & Ad. News 4621, 5222-23. The government concludes from this that because the predecessor to section 6303(a) required notice

only to an assessed party, therefore section 6303(a) also requires notice only to an assessed party, i.e., the employer. We declined to accept this somewhat scant legislative history as dispositive. First, section 3505 did not exist when section 6303(a) assumed its present form, so it is fruitless to speculate as to whether section 6303(a) was intended to apply to section 3505. Second, contrary to the government's assertion, it is unclear whether the predecessor to section 6303(a) would have required notice only to an employer in the context of a collection arising under section 3505.

We find, moreover, that the legislative history offers equal support for our position. The *Hunter* court noted that "[w]hile * * * statements [in the legislative history] are unequivocal and clearly indicate Congress' intent that lenders be liable within the ambit of section 3505(b), they do not indicate whether lenders are due the notice specified in section 6303(a)." *Hunter* at 1439. Unlike the *Hunter* court, we find that the plain language of section 6303(a) expresses the congressional intent that third-party lenders receive notice. Moreover, the absence of clear support in the legislative history for the government's position must be construed against the government. "[C]ongressional silence, no matter how 'elaborating,' cannot override the words of the statute." *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 105 S.Ct. 3275, 3285 n.13 (1985). In sum, we find that the legislative history, which is inconclusive at best, falls far short of the showing required to overcome the plain language of the statutes under discussion.

For the foregoing reasons, we agree with the view held by the Seventh Circuit in *Associates*,⁶ and followed by the Eleventh Circuit in *Merchants*, that the IRS must provide timely notice to a third-party lender when proceeding under section 3505(b).

FAIRCHILD, Senior Circuit Judge, dissenting.

Because I find the reasoning of *United States v. Jersey Shore State Bank*, 781 F.2d 974 (3rd Cir. 1986), cert. granted, 34 U.S.L.W. 3793 (U.S. June 2, 1986) (No. 85-1736) and *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d 1436 (9th Cir. 1986) more persuasive, I must respectfully dissent.

(p. 15) I add only two observations concerning the language at issue:

(1) An assessment is a determination that one or more persons are liable for a tax. It seems a natural reading of § 6303(a) that "each person liable for the unpaid tax" means each person whose liability has been deter-

⁶We note that the *Associates* court, in reaching its holding, followed what is perceived to be the Ninth Circuit's reasoning in *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311 (9th Cir. 1979), that notice to a third-party lender is required. The Ninth Circuit subsequently clarified its position in *Hunter*, stating:

Admittedly, our language can be interpreted to imply that notice to lenders is required. Indeed, courts have relied in substantial part on *Dixieline* to conclude that notice to lenders is required [citations omitted]. We believe that reliance was misplaced. * * * *Dixieline* does not alter our conclusion today that section 6303(a) does not require notice to third party lenders facing potential liability under section 3505.

Hunter at 1440. Our reading of *Associates* however, convinces us that its reasoning stands firm despite the loss of *Dixieline* to support its decision.

mined by the assessment referred to. The facts essential to liability of third-party providers are not determined by the assessment.

(2) Section 3505 does not, literally, make the third-party provider "liable for the unpaid tax," but "liable * * * in a sum equal to the taxes."

A true copy.

ATTEST:

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT.

(5)
No. 85-1736

Supreme Court, U.S.

FILED

AUG 1 1986

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CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

JERSEY SHORE STATE BANK,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to the United States
Court of Appeals for the Third Circuit

BRIEF OF THE AMICUS CURIAE
AMERICAN BANKERS ASSOCIATION
IN SUPPORT OF THE PETITIONER

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August 1, 1986

QUESTION PRESENTED FOR REVIEW

Whether a bank, which is alleged to be liable for the unpaid employee income withholding taxes and Federal Insurance Contribution Act taxes of its customer, is entitled to receive a notice of tax assessment where the Internal Revenue Code requires that such notice be provided to "each person liable for the unpaid tax."

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IN THE
Supreme Court of the United States
 OCTOBER TERM, 1985

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JERSEY SHORE STATE BANK,
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—
**On Writ of Certiorari to the United States Court
 of Appeals for the Third Circuit**
 —

**BRIEF OF THE AMICUS CURIAE
 AMERICAN BANKERS ASSOCIATION
 IN SUPPORT OF PETITIONER**
 —

INTEREST OF THE AMICUS CURIAE

The American Bankers Association is the principal national trade association of the commercial banking industry in the United States, representing member banks in each of the fifty states and the District of Columbia. One of the core functions of the banking industry is to lend funds to businesses for the conduct of their operations, including the payment of wages to employees. In consequence of this, commercial banks are the class most obviously and directly affected by Section 3505(b) of the Internal Revenue

Code. Enacted as a part of the Federal Tax Lien Act of 1966, this section makes lenders, sureties and other persons liable for certain unpaid taxes of employers to whom the lenders and others have advanced funds for the purpose of paying wages of employees. Liability is not automatic. The United States must show that the lender advanced funds "with actual notice or knowledge...that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax."

As we shall demonstrate in the sections of this brief which follow, the decision of the Third Circuit,¹ if allowed to stand, would have the effect of allowing the United States to file suits against banks, and maintain them, some nine years after the failure of the third party to pay taxes, without any prior notice to the banks. Under some circumstances, even this outrageously long period of time could be extended, almost indefinitely. Such a lengthy delay between the nonpayment of taxes by a third party and the filing of suit by the United States seriously impedes the

¹ The Court has granted a Writ of Certiorari in this case, no doubt in order to resolve a conflict within the circuits. The Third Circuit in the case below, *United States v. Jersey Shore State Bank*, 781 F.2d 974 (3d Cir. 1986) and the Ninth Circuit in *United States v. Hunter Engineers & Constructors, Inc.*, 789 F.2d 1436 (9th Cir. 1986) both concluded that the United States need not give notice to a third party lender of assessments against their borrowers for unpaid withholding taxes, and that failure to supply such notice does not bar an action by the United States against the third party lender. The Seventh Circuit, in *United States v. Associates Commercial Corporation*, 721 F.2d 1094 (7th Cir. 1983) and the Eleventh Circuit, in *United States v. Merchants National Bank of Mobile*, 772 F.2d 1522 (11th Cir. 1985), petition for cert. filed, No. 85-1480 (U.S., filed March 6, 1986), have reached a contrary conclusion.

ability of banks to defend themselves against stale claims.

The disposition of this case will affect a great many of our members. The Internal Revenue Service says that in 1984 some six million quarterly withholding tax returns were accompanied by no payment or only by partial payment of the taxes due. While the IRS attempts to collect the taxes by other means first, in about one case of every five thousand, efforts are eventually made to collect the unpaid taxes from third party lenders under Section 3505. (See United States Petition for a Writ of Certiorari at 11-12, *United States of America v. Merchants National Bank of Mobile*, No. 85-1480 (U.S. filed March 6, 1986). Even one case per five thousand would yield a total of 1,200 such efforts for 1984.

Accordingly, the American Bankers Association, with the consent of the parties, respectfully submits this brief as amicus curiae in order to represent the interests of its members who are not parties to the litigation.

SUMMARY OF THE ARGUMENT

The plain meaning of the applicable sections of the Internal Revenue Code dictate in two respects that banks, in this and comparable cases, are entitled to receive a notice of assessment of taxes for which they are liable if an assessment is made. First of all, the words of Section 6303 of the Code say so in no uncertain terms; secondly, there is simply no way in which the statute of limitations for tax collection actions can be given meaning and effect in the absence of a notice of assessment to a third party who is liable for the unpaid taxes of another. Without the

statute of limitations, the ability of such a third party taxpayer to defend itself against a tax collection suit would be seriously prejudiced. There are no realistic countervailing policy considerations which would dictate a different result, even if such policy considerations could enter into a determination of the legal issues raised by this case.

ARGUMENT

I. The Plain Meaning Of Section 6303 Requires The Government To Give Notice To Lenders Of Any Assessment Of Taxes For Which The Lender Is Liable

At bottom, this is a very simple case. Section 6303 of the Internal Revenue Code of 1954 provides, quite explicitly, that the Secretary of the Treasury *shall* "within 60 days, after the making of an assessment of a tax pursuant to Section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof."

Is the bank in this case a "person liable for the unpaid tax" of its borrower, Pennmount, or is it not? If the bank is not a "person liable for the unpaid tax," then the United States has no cause of action against the bank under Section 3505 of the Code. If the bank is a "person liable for the unpaid tax," then it is entitled to the notice required by Section 6303, and the failure of the United States to have provided it precludes a tax collection suit by the United States against the bank filed more than three years after the return was filed.

The statute refers to "*each* person liable for the tax" rather than *the* person liable for the tax. This obviously contemplates that more than one person could, under the proper circumstances, be found liable

for the same taxes—primarily or secondarily. However many "persons" may ultimately be found liable for the taxes, *all* are entitled to notice. This Court has held that when the word "each" is used to modify a noun (in that case, the word "employee") "(a) broader or more comprehensive coverage. . . would be difficult to frame." It "leaves no doubt as to the Congressional intention to include *all* employees within the scope of the Act unless specifically excluded." The term has an "unrestricted sweep." *United States v. Rosenwasser*, 323 U.S. 360, 362-363 (1945).

Once the plain meaning of the statute has been ascertained, it must simply be applied as written and the judicial process has come to an end. *TVA v. Hill*, 437 U.S. 153, 194-95 (1978). *See also Board of Governors of the Federal Reserve System v. Dimension Financial Corp.*, 106 S. Ct. 681, 689 n. 7 (1986).

II. The Third Circuit Opinion In The Case Below Deprives Banks Of The Benefit Of The Statute of Limitations To The Prejudice Of The Banks

Section 6501 of the Internal Revenue Code is the general statute of limitations provision for tax collection cases. It provides in relevant part that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed. . . and no proceeding in court without assessment for the collection of tax shall be begun after the expiration of such period." I.R.C. § 6501(a)(1982).

Any statute of limitations is enacted by Congress in order to protect potential defendants against stale claims. *Guaranty Trust Co. v. United States*, 304 U.S. 126, 136 (1938). Such statutes are enacted for good and valid public policy reasons, including the probable

unavailability of witnesses and records and faded recollections after the passage of time. Quite obviously, in the case of tax collections, Congress concluded that it would be fundamentally unfair to expect a party to defend itself against claims more than three years old. Despite that, the Third Circuit in the case below has authorized the government to file and maintain a suit against a bank for unpaid taxes that are not even the bank's own taxes, but rather the taxes of a third party borrower, and to file and maintain that suit for taxes that have remained unpaid for well over three years. As indicated above, the government may make an assessment of the taxes as much as three years after the filing of a return. If it does so, the "tax may be collected. . . by a proceeding in court, but only if the . . . proceeding [is] begun (1) within 6 years after the assessment of the tax." I.R.C. § 6502(a)(1) (1982). Consequently, the "statute of limitations" can effectively extend for a period of nine years. In addition to that, the six year statute of limitations on tax collections after the assessment is made is "suspended for the period the assets of the taxpayer are in the control or custody of the court in any proceeding before any court of the United States or of any State or of the District of Columbia, and for 6 months thereafter."² I.R.C. § 6503(b) (1982). This suspension of the statute of limitations can add indefi-

² This section usually applies to bankruptcy proceedings. See, e.g., *McCauley v. United States*, 525 F.2d 1108 (9th Cir. 1975); *United States v. Verlinsky*, 459 F.2d 1085 (5th Cir. 1972). In this, and predictably in most cases where the government asserts lender liability under Section 3505, the employer will be bankrupt. If the employer is not bankrupt, the government would seek, and probably be able to recover, unpaid taxes directly from the employer.

nitely to the nine-year period within which suit can be brought by the government for unpaid taxes.

It is difficult to square a general Congressional determination that tax cases become "stale" after three years with the virtually open-ended liability of a taxpayer resulting from application of Sections 6502(a)(1) and 6503(b) unless there is some device which serves the same function of providing notice to the defendant that the filing of a lawsuit would. Congress has provided just such a device. In Section 6303(a), the Internal Revenue Code provides that the government shall "within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof." Any "person" who destroys or loses necessary records or allows recollections to fade or to go unrecorded after receiving such a notice would only have himself, herself or itself to blame for any inability to defend against a suit brought by the government for the unpaid taxes six or ten years later. There is no question that the party really liable for the unpaid taxes in a case such as this is entitled to the statutory notice that it will, at some future time, be required to defend itself in a suit for unpaid taxes. But the Third Circuit in the case below has held that a party with only derivative liability for the tax is entitled to lesser consideration. That decision would deprive the statute of limitations and the policy considerations behind it of any meaning and effect with respect to this class of persons liable for taxes. And yet, statutes cannot be construed in such a fashion as to render parts of them inoperative. *Colautti v. Franklin*, 439 U.S. 379, 392 (1979).

Aside from the fact that Congress did not distinguish among parties entitled to the notice of assessment (providing that *each* person liable for the tax was so entitled), the considerations leading to the adoption of the statute of limitations in the first place are applicable to lenders liable for the unpaid taxes of employers under Section 3505.³

Like any other business, banks do not like to keep records any longer than necessary. The reason for this reluctance is obvious:

[E]ach new record takes up that much more space. After a while, the bulk becomes cumbersome and then outright unmanageable. What was once routine evolves into a desperate search for a place to store the mounting avalanche. Every added file clerk, every new file cabinet, each additional foot of dead storage space emphasizes the growing waste of space, time, energy and money to meet the demands for the retention of records.

Prentice-Hall, Inc., *Your Business Records: A Simplified Guide to What Records You Must Keep and How Long You Must Keep Them*, (1980) at 3.

Consequently, banks are inclined to destroy records once the period they are required by the government

³ The question has been raised in this and related cases whether a notice of assessment is a prerequisite to suit. Under the facts of this case, however, that question need not be answered. Even if the government may file suit without first providing a notice of assessment, it cannot take advantage of an extended statute of limitations unless it does so. The bank here should be entitled to summary judgment because the government has failed to file suit within the statute of limitations, and that statute of limitations was not extended in accordance with Section 6502(a)(1).

to keep those records expires. In fact, it is the national policy, under the Paperwork Reduction Act of 1980, "to minimize the Federal paperwork burden for individuals, small businesses, State and local governments and other persons." 44 U.S.C. § 3501(1) (1982). Among other things, the burden Congress sought to relieve by enactment of the Paperwork Reduction Act includes record keeping requirements imposed by the government. 44 U.S.C. § 3502(4). There are requirements imposed by the Secretary of the Treasury upon financial institutions to keep certain records which "have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings." 31 C.F.R. § 103.31 (July 1, 1985 Edition) (emphasis supplied). Among those records the Secretary requires financial institutions to keep is "a record of each extension of credit in an amount in excess of \$5,000. . . which record shall contain the name and address of the person to whom the extension of credit is made, the amount thereof, the nature or purpose thereof, and the date thereof." 31 C.F.R. § 103.33(a) (July 1, 1985 Edition).

The Secretary requires that these particular records "shall be retained for a period of 5 years." 31 C.F.R. 103.37(c) (July 1, 1985 Edition). In fact, the Internal Revenue Service has established a record retention period of four years for virtually all employment tax records. *See Guide to Record Retention Requirements*, Office of the Federal Register (1981) reproduced in relevant part as an Appendix to this brief. If the banks are obligated to keep such records for a period of four or five years, then, *ipso facto*, it must be entirely permissible to destroy those records after four or five years. Predictably, banks *rely* upon the Sec-

retary of the Treasury's rules and after this period would not ordinarily keep such records. Now, under the reasoning of the court below, the Secretary of the Treasury may bring suit against banks *nine* years or more after an extension of credit, with no prior notice to the banks of an intent to do so. Having therefore induced the banks into giving up the means of defending themselves, by virtue of his records retention regulations, the Secretary then seeks to take advantage of the banks' inability to conduct a meaningful defense to a claim of liability under Section 3505. That is an intolerable construction of the statute and should not be countenanced by this Court.

The failure of the government to give notice to the third party lender of an assessment of taxes against the employer prejudices the lender in other ways as well. As Judge Weis pointed out in his dissent in the case below, the receipt of timely notice would enable the lender to "arrange for payment, compromise, or take other steps in his own best interests. Without notice of the assessment, however, the party under § 3505 may not be alerted to this continuing exposure and concomitant risk. I am not convinced the Congress intended such an anomalous result." *United States v. Jersey Shore State Bank*, 781 F.2d 974, 984 (3d Cir. 1986). During a nine year period after the nonpayment of taxes by an employer, interest and penalties accrue for the nonpayment. Timely notice would allow the lender to cut off the accrual by payment of the taxes for which it might ultimately become liable. Without timely notice, the lender might continue to advance funds to the borrower, subjecting itself not only to greater potential liability for the borrower's unpaid taxes, but also to probable losses

on the loans themselves. A bank is not likely to find itself liable for the unpaid taxes of healthy corporate borrowers. Those borrowers already pay withholding taxes themselves or can be compelled to do so by the Internal Revenue Service without recourse to the remedies available under Section 3505. A claim against a bank under Section 3505 almost necessarily presupposes a seriously troubled taxpayer/borrower. A bank with knowledge that the borrower is in dire financial straits—knowledge which could be supplied by a notice of assessment—would be able to limit its losses on potentially bad loans by calling its existing loans to the borrower or at the very least by declining to advance additional funds.

III. Compliance With Section 6303 Imposes No Undue Burden Upon The Government

In order to avoid the plain meaning of the statute as described above, and to counterbalance the interests of the lenders in receiving fair warning of their potential liabilities at a meaningful time, the government claims an administrative burden in connection with providing the statutorily required notice of assessment. Such a requirement would allegedly result in

an unworkable enforcement scheme that, in practical effect, would largely nullify what Congress intended to be an important part of the tax-collection scheme. When the Commissioner makes an assessment of unpaid payroll taxes, he ordinarily will have no way of knowing whether the delinquent employer has borrowed money from a third party under circumstances that might render the lat-

ter liable under Section 3505. There is no indication on the face of a payroll tax return who the employer's creditors might be. . . . Nor could the Commissioner reasonably be expected, at the time he makes the assessment against the employer, to undertake to identify such lenders.

United States Petition for Writ of Certiorari at 11, *United States v. Merchants National Bank of Mobile*, No. 85-1480 (U.S., filed March 6, 1986).

The administrative burden, such as it is,⁴ is largely self-inflicted, and the government has the capacity to alleviate its own burden without assistance from the courts or the Congress. For example, the government complains that the payroll tax return does not identify an employer's creditors. And yet, it is the Internal Revenue Service which designed the payroll tax return. No law forbids the Internal Revenue Service from asking for this information, and indeed the Internal Revenue Code specifically vests in the Secretary of Treasury the authority to determine what information may be required by such forms. I.R.C. § 6011(a).

The concern for what the Commissioner might reasonably be expected to know at the time of making the assessment against the employer is relevant only if the Commissioner insists upon making the assessment, almost as a matter of rote, at the time he

⁴ The Seventh Circuit described this claim as "highly speculative and unsupported by any convincing statistics" in *United States v. Associates Commercial Corp.*, 721 F.2d 1094, 1099 (7th Cir. 1983).

receives a quarterly withholding tax return unaccompanied by full payment. There is no particular reason to do so. The law allows the Commissioner three years within which to make the assessment. During that long a period of time, there is plenty of opportunity to discover the identity of the employer's lenders, if any.

Even if the Commissioner makes an initial assessment at the time of receipt of a withholding tax return, he has the capacity under Section 6204 of the Code to make a supplemental assessment against the employer, subject to the same statute of limitations as the original assessment, if the original assessment was incomplete or imperfect in any way.

Finally, there is no particular reason why, within the three year statute of limitations, the Commissioner could not make a separate assessment of the lender's liability, even if circumstances prevent the Commissioner from rendering timely notice to the lender within sixty days of assessing the employer's liability. Again, the Commissioner has the capacity, under existing law, to take three years within which to conduct essentially the perfunctory investigation necessary to direct a simple notice form to the proper party. That cannot be such an outrageous "burden" upon him that Congress could not have intended to impose it, or that Congress would have opted in favor of allowing lawsuits against lenders, without prior notice, nine years after the fact rather than impose such a burden on the Commissioner.

CONCLUSION

For all of the reasons stated herein, the American Bankers Association, on behalf of the commercial banking industry, respectfully urges the Court to reverse the decision of the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

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August 1, 1986

APPENDIX

RECORD RETENTION GUIDE 1981

Federal Register Office GUIDE TO RECORD RETENTION REQUIREMENTS REVISION AS OF JANUARY 1, 1981

This is a Guide in digest form to the provisions of Federal laws and regulations relating to the keeping of records by the public. It tells the user (1) what records must be kept, (2) who must keep them, and (3) how long they must be kept.

The citation appearing at the end of each entry represents the title and section number of the Code of Federal Regulations. For example, 20 CFR 38.1 would refer to section 38.1 of title 20 of the Code of Federal Regulations.

The Guide is derived from the regulations published by the various agencies in the Code of Federal Regulations, as amended in the daily issues of the FEDERAL REGISTER through December 31, 1980. Authority for the regulations is derived from the laws published in the United States Code, as amended by laws enacted during 1980.

This Guide was prepared under the direction of Robert E. Lewis, assisted by Brenda A. Robeson and Wilma P. Greene. INQUIRIES, telephone 202-523-5233. SUGGESTIONS concerning this publication may be sent to John E. Byrne, Director, Office of the Federal Register, National Archives and Records Service, Washington, D.C. 20408.

Coverage

In preparing the Guide it was necessary to establish boundaries in order to keep it within its intended purpose.

The records covered by the Guide are those that address categories of activities conducted by individuals, busi-

nesses, and organizations for which retention requirements are expressly stated in the Code of Federal Regulations or certain public laws.

In many laws and regulations there is an implied responsibility to keep copies of records of reports and other papers furnished to Federal agencies and to keep related working papers. Such implied requirements have not been included in the Guide.

The following types of requirements also have been excluded from the Guide:

(1) Requirements involving the furnishing of reports to Government agencies, the filing of tax returns, or the submission of supporting evidence with applications or claims.

(2) Requirements directing the keeping of papers furnished by the Government, such as passports, licenses, permits, etc., unless they are closely related to other records which must be kept.

(3) Requirements involving the display of posters, notices, or other signs in places of business.

(4) Requirements contained in individual Government contracts, unless the contract provisions are incorporated in the Code of Federal Regulations.

Arrangement

The digests of recordkeeping provisions comprising the Guide are grouped under the departments or independent agencies which impose or administer them (see "Contents"). Individual items are numbered to simplify indexing. The names, addresses, and telephone numbers of contact persons within each agency are located at the end of the appropriate grouping.

In general, the entries retain their original numbers from year to year. Renumbering occurs only after a major re-

vision of the material and is so indicated in brackets after the name of the agency involved. Individual items revised, amended, deleted, or added are shown in brackets following the item heading.

Two supplements to the Guide contain generalized information about certain requirements under the Second War Powers Act of 1942 and detailed information on requirements imposed by the Federal Aviation Administration relative to the availability of credentials for inspection.

An index to the Guide follows the last supplement.

EMPLOYMENT TAX

Retention period: Regulations requiring the retention of employment tax records usually specify the number of years that such records must be retained. For some employment tax records, however, no specific retention period can be established and the "materiality rule" discussed in section 4.1 under *Income Tax* must be applied. Under the materiality rule, those records must be retained so long as they may become material in the computation of any tax.

Specific record retention requirements have not been assigned to the following and the materiality rule applies:

4.100 Vow-of-poverty religious orders electing social security coverage for its members. [Amended]

To maintain records of the details relating to the retirement of each of its members. 26 CFR 31.3121(a-1)(b)(4)

A specific record retention period has been established for the following employment tax records:

4.101 Employers required to deduct and withhold income tax on wages which include sick pay. [Amended]

To keep records with respect to payments (sick pay) made directly to employees under a wage continuation plan, and other information specified in the sections cited.

Retention period: 4 years after the due date of such tax for the return period to which the records relate or the date such tax is paid, whichever is later. 26 CFR 31.3401(a)-1(b)(8)(ii)(b) and (c), 31.6001-1, 31.6001-5

4.102 General record retention requirement for employment taxes.

(a) Persons required by regulations or instructions shall keep copies of any return, schedule, statement, or other document as part of their records.

(b) Any person who claims a refund, credit, or abatement shall keep records as indicated in the section cited.

(c) While not mandatory (except in the case of claims) it is advisable for each employee to keep permanent accurate records as indicated in the section cited.

Retention period: 4 years after the due date of such tax for the return period to which the records relate or the date such tax is paid, whichever is later. In the case of claimants, at least 4 years after the date the claim is filed. 26 CFR 31.6001-1

4.103 Employers liable for tax under the Federal Insurance Contributions Act. [Amended]

To keep records of all remuneration, whether in cash or in a medium other than cash, paid to his employees after 1954 for services (other than agricultural labor which constitutes or is deemed to constitute employment, domestic service in a private home of the employer, or service not in the course of the employer's trade or business) performed for him after 1936; and records of all remuneration

eration in the form of tips received by employees after 1965 and reported to him. Records shall include information specified in section cited.

Retention period: 4 years after the due date of such tax for the return period to which the records relate, or the date such tax is paid, whichever is later. 26 CFR 31.6001-1, 31.6001-2

4.104 Employers and employee representatives subject to the Railroad Retirement Tax Act. [Amended]

To keep records of all remuneration (whether in money or in something which may be used in lieu of money) other than tips, paid to his employees after 1954 for services rendered to him (including "time lost") after 1954 and such other records as specified in section cited.

Retention period: 4 years after the due date of such tax for the return period to which the records relate, or the date such tax is paid, whichever is later. 26 CFR 31.6001-1, 31.6001-3

4.105 Employers and persons who are not employers for purposes of the Federal Unemployment Tax Act. [Amended]

To maintain records as specified in the section cited to determine the correct liability or nonliability for the tax.

Retention period: 4 years after the due date of such tax for the return period to which the records relate or the date such tax is paid, whichever is later. 26 CFR 31.6001-1, 31.6001-4

4.106 Employers required to deduct and withhold income tax on wages paid. [Amended]

(a) To keep records of all remuneration paid to such employees and tips received by employees and reported to the employer. All employer is required to keep only charge receipts in connection with charged tips. (26 U.S.C. 6001 as amended by Pub. L. 95-600) Such records shall show

with respect to such employee, the information specified in the section cited.

(b) To retain the Internal Revenue Service copy and the employee copy of all undeliverable annual withholding statements.

Retention period: 4 years after the due date of such tax for the return period to which the records and statements relate, or the date such tax is paid, whichever is later. 26 CFR 31.6001-1, 31.6001-5, 31.6051-1(f)(3)

4.107 Employers claiming a refund, credit, or abatement of tax under the Federal Insurance Contributions Act or Railroad Retirement Tax Act.

Every employer who has filed a claim for refund, credit, or abatement of employer tax under section 3101 or section 3201 of the Code, or a corresponding provision of prior law, collected from an employee shall retain as part of his records, the written receipt of the employer showing the date and amount of the repayment, or the written consent of the employee, whichever is used in support of the claim. Where employee tax was collected under section 3101 of the Code, or a corresponding provision of prior law, from an employee in a calendar year prior to the year in which the credit or refund is claimed, the employer shall also retain as part of his records a written statement from the employee (a) that the employee has not claimed refund or credit of the amount of the overcollection, or if so, such claim has been rejected and (b) that the employee will not claim refund or credit of such amount.

Retention period: 4 years after the date the claim is filed. 26 CFR 31.6001-1, 31.6402(a)-2(a)(2), 31.6404(a)-1

4.108 Repayment by employer of tax erroneously collected from employee under the Federal Insurance Contributions Act or the Railroad Retirement Act and of income tax withheld from wages.

(a) *Before employer files return.* To obtain and keep as part of the records the written receipt of the employee showing the date and amount of the repayment.

(b) *After employer files return.* If the amount of an overcollection is repaid to an employee, the employer shall obtain and keep as part of the records the written receipt of the employee, showing the date and amount of the repayment. If in any calendar year, an employer repays or reimburses an employee in the amount of an overcollection of employee tax under section 3101 of the Code, or a corresponding provision of prior law which was collected from the employee in a prior calendar year, the employer shall obtain from the employee and keep as part of the records a written statement (a) that the employee has not claimed refund or credit of the amount of the overcollection, or if so, such claim has been rejected, and (b) that the employee will not claim refund or credit of such amount.

Retention period: 4 years after the due date of such tax for the return period to which the records relate, or the date such tax is paid, whichever is the later. The records of claimants shall be maintained for a period of at least 4 years after the date the claim is filed. 26 CFR 31.6001-1, 31.6413(a)-1

No. 85-1736

Supreme Court, U.S.
FILED
AUG 2 1986
JOSEPH F. SPANIOL, JR.
CLERK

In The
Supreme Court of the United States
October Term 1985

—○—
JERSEY SHORE STATE BANK,
Petitioner,
v.

UNITED STATES OF AMERICA,
Respondent.

—○—
**ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE THIRD CIRCUIT**

—○—
**BRIEF OF AMICUS CURIAE
FIRST ALABAMA BANK
IN SUPPORT OF PETITIONER**

—○—
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QUESTIONS PRESENTED

Section 6303(a) provides that the government, upon choosing to assess taxes unpaid by an employer, must give notice to each person liable for the unpaid tax. The questions presented are: (a) whether, as a prerequisite to the government's maintenance of a civil suit to collect a lender's § 3505 derivative liability for the assessed taxes, the government must comply with the general notice requirement of § 6303(a) by giving notice of the assessment to the lender, and (b) whether in the absence of such notice, the statute of limitation as it applies to the lender is extended.

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No. 85-1736

In The
Supreme Court of the United States
October Term 1985

JERSEY SHORE STATE BANK,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

**ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE THIRD CIRCUIT**

**BRIEF OF AMICUS CURIAE
FIRST ALABAMA BANK
IN SUPPORT OF PETITIONER**

INTEREST OF AMICUS CURIAE

Amicus curiae, First Alabama Bank, successor to The Merchants National Bank of Mobile (hereinafter "MNB"), is currently Respondent to a petition for writ of certiorari to the Eleventh Circuit Court of Appeals filed by the United States of America, No. 85-1480. The issue in that pe-

tition is identical to the one presented herein, though additional issues have been raised in a cross-petition for writ of certiorari filed by Respondent therein. This amicus curiae has received written consent from all parties to file this brief. (Appendix, 1a-2a).

SUMMARY OF ARGUMENT

The government has argued that this Court should interpret the clear and unambiguous language of § 6303(a) so as to cause it to fit neatly within its administrative practice of tax collection. Its appeal is addressed to the wrong forum, however, for it should seek relief from Congress and not this Court if it wishes to modify the simple yet meaningful § 6303(a) procedural safeguard for lenders subject to § 3505 liability.

The Third Circuit Court of Appeals in *United States v. Jersey Shore State Bank*, 781 F.2d 974 (3rd Cir. 1986) (Weis, J. dissenting) was the first appellate court to hold that the Congressionally mandated § 6303(a)¹ notice of the assessment of unpaid taxes is not required to be given a lender before maintenance of a suit to collect purported lender's derivative liability for those taxes under § 3505. Both the Seventh Circuit in the *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983) and the Eleventh Circuit in *United States v. Merchants National Bank of Mobile*, 772 F.2d 1522 (11th Cir. 1985) (per cur-

¹All references are to the Internal Revenue Code of 1954 (26 U.S.C.) unless otherwise noted.

iam), petition for *cert. pending*, No. 85-1480, had previously held that such notice is required by the plain words of the statute. They each rejected the government's arguments that § 6303(a) applied only to administrative collection proceedings and that giving § 6303(a) notice to lenders is impossible.

Subsequent to the divided opinion of the Third Circuit in *Jersey Shore*, the Ninth Circuit issued its opinion in *United States v. Hunter Engineers & Constructors, Inc.*, No. 84-2652, (May 21, 1986), adopting the rationale of the Third Circuit in *Jersey Shore*, and holding that the government's failure to give the lender (in that particular case, a non-bank lender) § 6303(a) notice of the assessment of unpaid taxes did not bar the subsequent action to enforce § 3505 liability nor prevent the extension of the statute of limitations under § 6502(a)(1) and Treas. Regs. § 31.3505-1(d)(1), 26 C.F.R. § 31.3505-1(a)(1).

As framed by these four (4) opinions, the issues have become (i) whether the government must give § 6303(a) notice of assessment to a lender alleged to be liable under § 3505, and, if so, (ii) whether the consequences of the failure to do so are (a) an absolute bar of civil liability under § 3505 or (b) waiver of the extension of the statute of limitations for commencement of a § 3505 action if such extension is valid in the first place.

The Seventh and Eleventh Circuits correctly read § 6303(a) as being a general rule applicable to all collection methods instituted by the Secretary of the Treasury, unless a special rule applies. Section 3505 and its regulations contain no exception to that general rule.

The government contends that § 6303(a) is restricted to the administrative collection process and has no application to the judicial collection process. This argument focuses on the idea that assessment relates only to administrative collection from the employer and that § 6303(a) notice of the assessment and demand for payment must be sent only to employers and not to lenders, who are liable only by way of civil proceeding. However, § 6303(a) is contained in Subtitle F of the Internal Revenue Code, and Subtitle F controls *all* of the procedures by which the Secretary of the Treasury may institute collection of taxes, including litigation.

Assessment is not a mere formality that relates only to the administrative collection activities against the employer. It acts to automatically extend the statute of limitation under § 6502(a)(1), which has been engrafted into Treas. Regs. § 31.3505-1(d)(1) for prosecution of a § 3505 claim. Where the employer receives notice of the assessment and the lender does not, it would be manifestly unfair to extend the statute of limitations against both. No other provision of the tax collection process against persons derivatively liable (*e.g.*, § 6672 responsible officer penalties, § 6901 transferee penalties) produces such a prejudicial circumstance and results in such an inherently unfair recovery process. Certainly, Congress recognized this and plainly intended that the lender should receive the same procedural safeguard as the taxpayer-employer.

ARGUMENT

I. Congress is the only Appropriate Forum for Revision of § 6303(a).

A. The Language of § 6303(a) is Unambiguous.

The beginning point of interpreting any statute is the language of the statute itself, as noted in *Consumer Products Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 100 S.Ct. 2051, 64 L.Ed.2d 766 (1980), wherein this Court stated:

We begin with the familiar canon of statutory construction that the starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive.

447 U.S. at 108.

The Seventh Circuit, Eleventh Circuit and Judge Weis, dissenting from the Third Circuit's opinion in *Jersey Shore*, all recognized that the phrase "each person liable for the unpaid tax" in § 6303(a) is not in the least ambiguous.

Judge Weis, in particular, examined the legislative history of both §§ 6303(a) and 3505, rather than limiting his inquiry only to the legislative history of § 6303(a) and Reorganization Plan No. 26 of 1950, 5 U.S.C.A. App. at 274, 15 F.R. 4935, 64 Stat. 1280, and Reorganization Plan No. 1 of 1952, 26 U.S.C.A. § 7804 (Historical Note), 17 F.R. 2243, 66 Stat. 823, as argued by the government to support its contention that § 6303(a) does not require notice to a § 3505 lender.

It is important to note that § 3505 derivative liability did not exist at the time the Reorganization Plans and § 6303(a) were adopted. Judge Weis' clarity in reviewing all appropriate legislative history and synthesizing the interplay of § 6303(a) and § 3505 is succinctly set forth in his dissenting opinion:

In this case, I cannot even say with assurance that the addition to the statute that the IRS proposes was inadvertently omitted. Certainly, the legislative history of § 6303 provides no basis for such a belief. Moreover, the legislative history of § 3505 does not suggest that notice should not be provided lenders who may be secondarily liable. "Congressional silence, no matter how 'clanging,' cannot override the words of the statute." *Sedima v. Imrex Co., Inc.*, — U.S. —, 105 S.Ct. 3275, 3285 n.13, 87 L.Ed.2d 346 (1985).

781 F.2d at 984.

The majority in *Jersey Shore* failed to address the fact that at the time of adoption of the 1954 Code, there was no derivative liability that did not provide for separate notice and assessment. When Congress used the phrase "each person liable for the unpaid tax" it must have intended to guarantee notice of assessment to each person liable for the unpaid tax. Neither § 3505 or its legislative history indicates any intent to exempt a lender from such notice. Thus, there is no clearly expressed legislative intention which is contrary to the ordinary meaning of the phrase "each person liable for the unpaid tax."

B. Congress is the Only Proper Forum for the Government to Seek a Rewrite of § 6303(a).

Whatever merit there may be, if any, in the government's argument regarding the duty or burden of giving

notice, it is a matter for Congress, not this Court. Judge Weis, in his dissent to the majority opinion in *Jersey Shore*, answered this argument best:

The IRS wishes us to redraft that section so that it requires notice only to those individuals against whom taxes have been assessed. The reasons offered for this revision have some logic and would possibly ease administrative burdens on the government, but the arguments are directed to the wrong forum. *They should be presented to Congress, not the courts.*

In *Iselin v. United States*, 270 U.S. 245, 251 (1926), the Supreme Court said that courts should not revise a statute so that "what was omitted, presumably by inadvertence, may be included within its scope. To supply omissions transcends the judicial function."

The courts' limited role was reemphasized in *TVA v. Hill*, 437 U.S. 153 (1978). Once "Congress has spoken in the plainest of words" and "the meaning of an enactment is discerned . . . the judicial process comes to an end. We do not sit as a committee of review, nor are we vested with the power to veto." Courts may not "pre-empt congressional action by judicially decreeing what accords with 'common sense and the public weal.' Our Constitution vests such responsibilities in the political branches." *Id.* at 194-95.

781 F.2d at 983-84 (emphasis added).

For these reasons, this Court should enforce the plain meaning of the language of § 6303(a), leaving the government to petition Congress for any requested revision.

II. The Government's Failure to Give Timely §6303(a) Notice of Assessment to a Lender Bars any Suit Alleging Lender's Liability under §3505.

A. The Notice was Required to be Given.

1. The Genesis of §6303(a).

Section 6303(a) provides as follows:

General Rule - Where it is not otherwise provided by this title, the secretary or his delegate *shall*, as soon as practicable, and within sixty (60) days, after the making of an assessment of a tax pursuant to section 6203, *give notice to each person liable for the unpaid tax*, stating the amount and demanding payment thereof. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address. [Emphasis added].

Section 6303(a) was derived, in part, from § 3655 of the Internal Revenue Code of 1939 (hereinafter "1939 Code"), which provided:

Delivery. Where it is not otherwise provided, the collector shall in person or by deputy, within ten (10) days after receiving any list of taxes from the Commissioner, give notice to each person liable to pay any taxes stated therein, to be left at his dwelling or usual place of business, or to be sent by mail, stating the amount of such taxes and demanding payment thereof.

The "list of taxes from the Commissioner" identified in § 3655 refers to § 3641 of the 1939 Code, which provided that "[t]he Commissioner shall certify a list of such assessments when made to the proper collectors, respectively, who shall proceed to collect and account for the taxes and penalties so certified."

Thus, prior to adoption of the 1954 Code by Congress,² only the Tax Collector was required to give notice, and only to each person liable to pay any taxes stated in the certified list of assessments made by the Commissioner. This dichotomy of function between the Tax Collectors, on the one hand, and the Commissioner of Internal Revenue, on the other hand, appears to be the pivotal rationale in those cases which addressed a Tax Collector's failure to give notice of the assessment under the predecessors to § 6303(a). See *Jenkins v. Smith*, 99 F.2d 827 (2d Cir. 1938) (§ 1545 of Internal Revenue Code of 1926); *United States v. Erie Forge Co.*, 191 F.2d 627 (3rd Cir. 1951) (§ 3655 of the 1939 Code).

The Second and Third Circuits held in *Jenkins* and *Erie Forge*, respectively, that only the Tax Collector, who could collect taxes only by administrative collection proceedings, was barred from collection by failure to give notice under the predecessors to § 6303(a), but that such failure was "immaterial in an action by the United States, since such a suit is brought 'either upon the assessment, or upon the duty imposed by the statute alone'." 99 F.2d at 828; 191 F.2d at 631.³

²Actually, Reorganization Plans No. 26 of 1950 and No. 1 of 1952 began the reorganization of the Department of Treasury by transferring the functions of the Commissioner and Tax Collectors, among others, to the Secretary and abolishing those functionless offices, respectively. These plans are carried over into the 1954 Code under § 7804(a). For ease of reference, MNB shall refer to adoption of the 1954 Code as the focal point herein.

³The rationale for such holdings would appear to be based on the government's right to bring suit against the employer

(Continued on following page)

In adopting the 1954 Code, particularly § 6303(a),⁴ Congress did not address the implication of placing the burden of notice and demand on the Secretary after transfer of the functions of the Tax Collectors and abolishment of those presidentially appointed offices, any inherent changes in procedure caused by combination of the functions of the Commissioner and Tax Collectors under the office of the Secretary, nor the conversion of the notice and demand statute into a "general rule" as opposed to a "delivery" rule under the predecessor statutes.

Moreover, Congress did not address the inclusion of the phrase "after the making of an assessment of a tax pursuant to § 6203" in place of the predecessor phrase "after receiving any list of taxes from the Commissioner" in § 3655 of the 1939 Code. Section 6203⁵ specifically recognizes the burden of assessment on the Secretary and

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based simply on its common law right to sue on the debt, which exists independently of any statute, and that the Commissioner, not the Tax Collector, was the only officer authorized to proceed by suit under § 3740 of the 1939 Code and its predecessors, and he had no statutory duty to provide notice to anyone. See, e.g., *Dollar Savings Bank v. United States*, 86 U.S. (19 Wall.) 227, 239-40 (1874); *Damsky v. Zavatt*, 289 F.2d 46, 51 (2nd Cir. 1946). See also *United States v. Jersey Shore State Bank*, 781 F.2d 974, 979 n.4 (3d Cir. 1986).

⁴Congress stated in the Committee Reports that § 6303 "contains two changes from existing law", neither of which has any particular relevance herein. H.R. Rep. No. 1337, 83rd Cong., 2d Sess. at 405 ([1954] 3 U.S. Code Cong. & Ad. News 4017, 4553); S. Rep. No. 1622, 83rd Cong., 2d Sess. at 574 ([1954] 3 U.S. Code Cong. & Ad. News 4621, 5222-5223).

⁵Section 6203 provides that, "[t]he assessment shall be made by recording the liability of the taxpayer . . .". [Emphasis added].

uses the restrictive term "taxpayer" as opposed to the broad phrase "each person liable for the unpaid tax", so that only the taxpayer is assessed. Thus, under the 1954 Code, § 6203 requires the Secretary to assess the liability of the taxpayer-employer by recording same, and then requires the same Secretary to give notice under § 6303(a) of said assessment to "each person liable for the unpaid tax," as opposed to only the "taxpayer" so assessed.⁶

Upon adoption of the 1954 Code, the Secretary exercised all functions of tax collection, whether by administrative process or civil proceedings. The general rules regarding collections therefore require the Secretary to give § 6303(a) notice to each person liable for an assessed tax without reference to the collection mechanism employed.

At the time of adoption of § 6303(a), Congress could not have envisioned nor discussed the effect of the later adoption of lender's derivative liability in § 3505, as such was not even contemplated in 1954. After adoption of the 1954 Code and before enactment of § 3505 in 1966, each person liable for the unpaid tax was given § 6303(a) notice by the government since no statutory derivative liability existed during that period which did not provide

⁶Furthermore, § 6303(a) is found in Subtitle F of the 1954 Code, entitled "Procedure and Administration", Chapter 64, entitled "Collection", Subchapter A, entitled "General Provisions." Subtitle F also includes § 7401, authorizing the commencement of civil actions by the Secretary "for the collection or recovery of taxes . . .". (Emphasis added). Clearly, Congress did not give the government license to choose which parts of Subtitle F it would apply the general rule of § 6303(a) to and which it would not.

for separate notice and assessment (e.g., § 6672 responsible officer penalties and § 6901 transferee liability).

2. The Genesis of §3505.

Section 3505 provides, in part, as follows:

(a) *Direct Payment by Third Parties*—For purposes of sections 3102, 3202, 3402, and 3403, if a lender, surety, or other person, who is not an employer under such sections with respect to an employee or group of employees, pays wages directly to such an employee or group of employees, employed by one or more employers, or to an agent on behalf of such employee or employees, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer.

(b) *Personal Liability Where Funds Are Supplied*—If a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required by this subtitle to be deducted and withheld by such employer from such wages, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer with respect to such wages.

Section 3505 was enacted as part of the Federal Tax Lien Act of 1966, Pub. L. 89-719, in order to stem the loss

of revenue occasioned by the practice of financing “net” payrolls by lenders, sureties and other such persons.⁷

In imposing the derivative liability of § 3505 on lenders, and, in effect, creating a new tax liability unknown at common law or in previous Internal Revenue Codes, Congress did not address the procedure and administration for collection of this tax liability, except to advise that the Secretary had to proceed by appropriate civil proceeding. Congress specifically did not address any exemption of § 3505 from the general notice requirements of § 6303(a), nor the extension of the statute of limitations for collection of § 3505 liability by assessment of taxes unpaid by the employer pursuant to § 6502(a)(1).

However, the legislative history of § 3505 indicates that Congress was placing the lender in the shoes of the employer as to liability for the unpaid taxes in the specific cases set forth under § 3505, but restricting the Secretary to appropriate civil proceedings as his sole remedy. Congress stated:

Third persons who pay wages directly to employees ordinarily have full access to payroll information and, therefore, have essentially the same ability to determine the amount of wages due, and control over funds available for payment, as is usually true in the case of employers. Therefore, no admin-

⁷It is well settled that § 3505 does not require or, indeed, permit a separate assessment to be made against the third party lender, *United States v. First National Bank of Circle*, 652 F.2d 882 (9th Cir. 1981); *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311 (9th Cir. 1979), such that the government must proceed to collect § 3505 liability only by appropriate civil proceedings. See H.R. Rep. No. 1884, 89th Cong., 2d Sess. at 65-66 (1966-2 C. B. 815 at 861-62).

istrative problems are expected in these cases by holding the third parties liable for withholding taxes. [Emphasis added].

• • •

Third parties who specifically finance payrolls, although not paying employees directly also are often in positions similar to that of employers. This appears to be true in those cases where they have actual such knowledge that the employers do not intend to, or are unable to, pay the amount of withholding taxes due the Government. Therefore, in these cases also it would appear practical for those third parties to account for withholding taxes to the Government. [Emphasis added].

H.R. Rep. No. 1884, *supra*, at 20 (1966-2 C. B. at 829); S. Rep. No. 1708, 89th Cong., 2d Sess. at 22 (1966-2 C. B. at 891).

Clearly, Congress set forth the concept of lender's derivative tax liability under § 3505 by placing the lender in the shoes of the employer as to liability for unpaid withholding taxes under those two factual situations. Yet, prior to adoption of § 3505 in 1966, each person liable for those taxes was required to receive notice and demand for payment under § 6303(a) once unpaid taxes had been assessed, and it is abundantly clear that § 3505 does not exclude lenders from the general rules of procedure under Subtitle F.

Must not, then, Congress have intended that the lender, whose liability is derivative of the liability of the employer for failure to pay withholding taxes, receive the same procedural safeguard given the employer, specifically that of § 6303(a) notice? Certainly, Congress knew that § 3505 liability would be subject to the general col-

lection rules, and that § 6303(a), a general collection rule, requires that notice be given not only to the taxpayer, but to "each person liable for the unpaid tax."

Congress does not act in a vacuum and it must be credited with having certain equities and procedural safeguards in mind when enacting § 3505. In order to extend the statute of limitations against the employer for six (6) years under § 6502(a)(1), the government must assess the tax and give notice to the taxpayer-employer pursuant to § 6303(a) within sixty (60) days of the assessment. It makes no sense that Congress, in creating the derivative liability of a lender, would allow extension of the statute of limitations against the lender without notice of the assessment.

Under the government's view, the lender would not be apprised of non-payment or assessment, would not be given notice of assessment and would not know that he may be claimed to be derivatively liable for said assessed taxes under Treas. Regs. § 31.3505-1(d)(1), engrafting § 6502(a)(1) and extending the period for collection for six (6) years after assessment of the employer. Since the liability of the lender is derivative of the liability of the employer, surely the procedural safeguards afforded the employer must at least be afforded the lender, particularly since such safeguards were not specifically withheld by Congress.⁸

⁸The government lamely argues that it is simply impossible to give lenders notice of assessment because its administrative practice does not provide for a quick determination of who the lenders are and that such a procedure would place such an

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3. **The Third and Ninth Circuits Erred in Statutory Construction of the Interplay Between § 3505 and § 6303(a).**

The Third and Ninth Circuits in *Jersey Shore* and *Hunter Engineers*, respectively, ignored the canon of construction set forth by this Court in *GTE Sylvania, supra*. Only by strained effort could it contort the unambiguous phrase of § 6303(a) "each person liable for the unpaid tax" into the phrase "taxpayer so assessed," and thereby render null to the lender the procedural safeguard afforded the employer.

Those courts reviewed the Reorganization Plans for the Internal Revenue Service promulgated by President Truman in 1950 and 1952, the resulting consolidation of functions in the Secretary and abolishment of the office of Tax Collector, to find what each court considered a "clearly expressed legislative intention" that notice was dependent on the means of collection rather than the per-

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onerous burden on the government that § 3505 liability would be an effective nullity. Such an argument bemoans a certain bureaucratic malaise. For example, the government could reform the employer's tax return under § 6011(a) to list all lenders and give them notice after assessment; make a supplemental assessment under § 6204 if the first is incorrect "in any way", and then give notice; or simply delay assessment until after investigation of the non-payment of taxes has been completed within the time frame of § 6501(a). In any event, this lame argument has no application to the situation where the government has actual knowledge of the lenders identity before assessment and/or notice. See *United States v. Merchants National Bank of Mobile*, 772 F.2d 1522 (11th Cir. 1985), petition for cert. pending, No. 85-1480.

son (being the Secretary) who commences the collection process. Their collective reasoning was in error.

First, § 6303(a) does not refer to the means by which collection activities are commenced by the Secretary. It purely, simply and directly requires the Secretary to give notice after assessment. All means of collection are vested in the Secretary. Thus, the clear language of § 6303(a) applies to the person initiating collection activities, and not the means by which collection is accomplished. Had Congress intended such a distinction after having merged the functions of collection and abolished the two separate offices responsible for collection, it could have easily said so.

Second, prior to adoption of § 3505 in 1966, the § 6303 (a) notice to the employer given by the Secretary after assessment was required whether the Secretary intended to collect the taxes from the taxpayer-employer by administrative means or by later civil action pursuant to § 7401.⁹ The notice is therefore not dependent on the means chosen, but is binding on the Secretary as the officer charged with collection of taxes after assessment, whether by administrative means or litigation.

Finally, the Third and Ninth Circuits focused on the legislative history of § 6303(a), and ignored entirely the legislative history of § 3505. The general notice rule of § 6303(a) preceded adoption of § 3505, and applies as a

⁹While the failure to give such notice would not bar the Secretary from bringing suit against the taxpayer with the statutory duty to pay the tax within the normal limitations period, *supra*, note 3, it should prevent extension of the statute of limitations based on such assessment.

general rule "unless otherwise provided." Section 3505 does not "otherwise provide" and there is nothing in its legislative history to indicate that Congress intended to provide otherwise, as noted by Judge Weis in his dissent in *Jersey Shore*. 781 F.2d at 984.

The Third and Ninth Circuits erroneously adopted the administrative practice of the government as its guide through the statutory framework for collection of § 3505 liability, rather than apply the statutes to govern such practice.

There is no clearly expressed legislative intention that the words employed by Congress in § 6303(a) should not receive their plain meaning. *Quinlivan v. Commissioner*, 599 F.2d 269 (8th Cir. 1979); *cert. denied* 444 U.S. 996, 100 S. Ct. 531, 62 L. Ed. 2d 426 (1979); *Conway County Farmers Association v. United States*, 588 F.2d 592 (6th Cir. 1978). The government asserts that a § 3505 lender is a person liable for the unpaid tax, so it must be bound by the everyday, ordinary sense of those words as Congress used them in § 6303(a).

B. Failure to Give the Lender § 6303(a) Notice Bars § 3505 Liability.

The Seventh and Eleventh Circuits in *Associates* and *Merchants National Bank of Mobile*, respectively, held that the consequences of the failure of the government to give the lender § 6303(a) notice was an absolute bar of § 3505 liability. The government counters these holdings by arguing herein, as it did in the Eleventh Circuit, that it is not required to give notice of an assessment because any action against the lender is merely a common law action on a debt.

The common law action on a debt as argued by the government refers to actions against a taxpayer who bears a statutory duty to pay a tax. That rationale simply does not apply in a § 3505 action,¹⁰ for the lender is liable only under certain limited circumstances and has no duty to pay the tax, only a duty to pay a judgment imposing civil liability under § 3505.

The Seventh Circuit in *Associates* noted that there was a fundamental reason for a lender to receive notice, stating:

Section 6303(a) requires notice of the assessment of unpaid taxes in order to protect the taxpayer, *Macatee, Inc. v. United States*, 214 F.2d 717, 719 (5th Cir. 1954), and this rationale applies regardless of which collection mechanism is used.

721 F.2d at 1100.

Thus, once the government proceeds with the assessment of the tax, it must adhere to the statutory requirements of § 6303(a) notice to a lender, so as not to leave the lender at the mercy of the government for collection of § 3505 liability. There are important policy considerations in requiring the government to give § 6303(a) notice to extend the statute of limitation under § 6502(a)(1). Judge Weis, in his dissent in *Jersey Shore*, adequately pointed these out:

The net affect of the Code revision urged by the IRS is to give less procedural protection to one secondarily liable than to the primary obligor. The notice of

¹⁰Section 3505 liability is not and has never been a common law debt of a taxpayer. Rather, it is a derivative liability of a third party under limited circumstances created by statute, and enforceable, if at all, pursuant to the enforcement statutes of Subtitle F. *United States v. Merchants National Bank of Mobile*, 772 F.2d 1522, 1524, n. 1 (11th Cir. 1985).

assessment will alert the taxpayer directly liable to the lengthened statute of limitations. He may then preserve pertinent records, arrange for payment, compromise, or take other steps in his own best interests. Without notice of the assessment, however, the party under § 3505 may not be alerted to his continuing exposure and concomitant risk. I am not convinced that Congress intended such an anomalous result.

781 F.2d at 984.

Since the lender stands unprotected without notice, the failure of the government to give same must constitute a bar to a civil proceeding to collect § 3505 liability from that lender.

III. The Government May Not Validly Extend the Statute of Limitation to Collect § 3505 Liability.

A. The Framework for Extension of the Limitation Period.

The statute of limitations on assessment and collection of unpaid taxes is set forth in § 6501(a), which provides as a general rule, the following:

Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, *and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.* [Emphasis added].

This general three (3) year statute of limitations predates the adoption of § 3505 in 1966. Congress provided no specific statute of limitations for § 3505 liability, and hence,

the general rule of § 6501(a) applies, particularly since Congress did not authorize the government to separately assess the § 3505 tax liability.

Section 6502(a)(1) operates as an exception to the general rule as to collection of unpaid taxes *after assessment*, and provides:

Where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy *or by a proceeding in court*, but only if the levy is made or the proceeding begun—

(1) within six (6) years after the assessment of the tax [Emphasis added].

In adopting § 3505, Congress did not provide for any specific extension of the statute of limitations for § 3505 liability. However, the government has engrafted § 6502(a)(1) into the Treasury Regulations promulgated under § 3505, providing at Treas. Reg. § 31.3505-1(d)(1) as follows:

In the event the lender, surety, or other person does not satisfy the liability imposed by section 3505, the United States may collect the liability by appropriate civil proceeding commenced within six (6) years after assessment of the tax against the employer.

B. The Government May Not Extend the Statute of Limitation for § 3505 Liability Since There is no Separate Assessment.

In enacting § 3505, Congress did not give the government the authority to assess § 3505 liability, *United States v. First National Bank of Circle*, 652 F.2d 882 (9th Cir. 1981); *United States v. Dixieline Financial, Inc.*, 594 F.2d 1311 (9th Cir. 1979), and did not set forth any statute of

limitation for same or guidelines for any alleged extension of said statute of limitation for § 3505 liability after assessment of the employer. The government took it upon itself to provide in the Treasury Regulations that it may arbitrarily extend the statute of limitation after assessment against the employer, engrafting the provisions of § 6502(a)(1) into the procedure and administration for collecting § 3505 tax liability, even though Congress did not specifically give it that power.

Section 6502(a)(1) begins with the phrase "[w]here the assessment of any tax imposed by this title has been made . . .". An assessment of tax is made under § 6203 "by recording the liability of the taxpayer in the office of the Secretary . . .".

The liability of a lender under § 3505 is not assessed nor recorded in the office of the Secretary.¹¹ Since any assessment was made against the taxpayer-employer by recording the liability of the taxpayer-employer in the office of the Secretary, then it would appear clear that such assessment, relating only to the employer's statutory duty to pay said taxes, cannot apply to an unassessed lender for § 3505 liability.

Therefore, there being no exception by assessment of the lender to the § 6501(a) general three (3) year statute of limitations provided by Congress, that § 6501(a) statute of limitations is always binding on the government in § 3505 actions.

¹¹Arguably, § 3505 liability is not a "tax imposed by [title 26]" since § 3505 merely defines those circumstances in which liability attaches rather than creates a statutory duty to pay the employment taxes.

Any purported extension of this statute of limitation by a Treasury Regulation engrafting § 6502(a)(1) into proceedings for collection of § 3505 liability is clearly unauthorized, as there is no Congressional mandate that directs or provides for such an extension. For lack of such a mandate, the regulation is invalid. *Rowan Companies, Inc. v. United States*, 452 U.S. 247, 101 S. Ct. 2288, 68 L. Ed. 2d 814 (1981); *Chen Chi Wang v. United States*, 757 F.2d 1000 (9th Cir. 1985); *First Charter Financial Corp. v. United States*, 669 F.2d 1342 (9th Cir. 1982).

C. At a Minimum, Failure to Give § 6303(a) Notice to a Lender Prevents Extension of the Statute of Limitation.

Even if the government may validly engraft § 6502(a)(1) into the Treasury Regulations under § 3505 to extend the statute of limitation, the failure of the government to give § 6303(a) notice to the lender of the assessment of taxes unpaid by the employer must be a bar to extension of the statute of limitation as to the lender.

The government has consistently argued in each of the appeals in the Seventh, Eleventh, Third and Ninth Circuits, respectively, that for purposes of § 6303(a), the assessment applies only to the administrative collection process. As the argument continues, notice of assessment is therefore only required to be given by the government to those persons subject to administrative collection proceedings, in other words, the taxpayer-employer, and not to a lender derivatively liable for said unpaid taxes under § 3505.

Yet, the government also asserts that the act of assessment, which allegedly relates only to the administra-

tive collection process, also applies to "appropriate civil proceedings" under § 7401 to collect § 3505 liability, by extending the statute of limitation against a lender through the Treasury Regulations which engraft § 6502(a)(1).

These two positions are logical contradictions.¹² Either assessment does not apply to or effect § 3505 liability, such that no § 6303(a) notice is required and no extension of the statute of limitation after assessment of the employer is allowed, or assessment does apply to the government's procedure for collecting § 3505 derivative liability by appropriate civil proceeding, such that § 6303(a) notice is required and the statute of limitation for collection of said liability may be extended under the Treasury Regulations which engraft § 6502(a)(1).

There are also important policy considerations in giving notice as a prerequisite to extending the statute of limitation against a lender. For example, corporate officers of the taxpayer-employer may attempt to pass liability for the taxes to a lender under § 3505 to avoid potential liability under § 6672 for responsible officer penalties. Their interests are diametrically opposed to that of the lender. It would be unjust and prejudicial for the employer and corporate officers to have notice of assessment so that defenses to such penalty can be prepared, while the

¹²Both § 6303(a) and § 6502(a)(1) appear in Subtitle F of the 1954 Code. Both relate to the duties and responsibilities of the government after assessment of the tax unpaid by the taxpayer-employer. The government's illogical position is that a lender liable for § 3505 derivative liability does not qualify as "each person liable for the unpaid tax" under § 6303(a), but does qualify as a person liable for the tax and bound by the effect of the assessment against the employer under § 6502(a)(1). The government simply cannot have it both ways.

lender is given no notice to prepare a defense for potential § 3505 liability. See *United States v. American Bank & Trust*, 623 F. Supp. 708 (E.D. Pa. 1985), appeal pending, No. 85-1615 (3rd Cir.).

Ordinary statutory construction dictates the conclusion that failure to give § 6303(a) notice to a lender alleged to be subject to § 3505 liability must operate to prevent extension of the statute of limitation. Otherwise, the government can merely choose which provisions of Subtitle F it wishes to abide by and which others it chooses to ignore.

CONCLUSION

For the foregoing reasons, the judgment of the Third Circuit Court of Appeals should be reversed.

Respectfully submitted,

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August, 1986

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APPENDIX

U.S. Department of Justice
Office of the Solicitor General
Washington, D.C. 20530

July 14, 1986

Alan C. Christian, Esq.
Johnstone, Adams, Howard, Bailey
and Gordon
104 St. Francis Street
Eighth Floor
Post Office Box 1988
Mobile, Alabama 36633

Re: Jersey Shore State Bank v. United
States of America, No. 85-1736

Dear Mr. Christian:

As requested in your letter of July 9, 1986, I hereby
consent to the filing of a brief amicus curiae on behalf of
Merchants National Bank of Mobile in the above case.

Sincerely,

/s/ Charles Fried
Solicitor General

CARPENTER, HARRIS & FLAYHART

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128 South Main Street
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July 21, 1986

Alan C. Christian, Esq.
Johnstone, Adams, Howard, Bailey and Gordon
104 St. Francis Street, 8th Floor
P.O. Box 1988
Mobile, Alabama 36633

Re: Jersey Shore State Bank v. United States
No. 85-1736
United States Supreme Court

Dear Mr. Christian:

Pursuant to Rule 36 of the Rule of the United States Supreme Court, Jersey Shore State Bank, as Petitioner in the above captioned matter, hereby gives its consent to the filing of an amicus curiae brief by Merchants National Bank of Mobile on behalf of the said Petitioner.

Very truly yours,

CARPENTER, HARRIS
& FLAYHART

/s/ Martin A. Flayhart

cc: Hon. Charles Fried
Solicitor General